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United States Multinational Corporations: The Impact of Foreign Direct Investment on United States Foreign Relations

CLARKE N. ELLIS*

INTRODUCTION

That multinational corporations (MNCs) have an impact on a nation's foreign relations is an assertion of which there is very little doubt. The world's media in recent years have been filled with examples, frequently emphasizing the cases where the impact has been a negative one. At the same time, relatively little serious study has been done on the specific ways in which these dynamic entities affect U.S. foreign relations. One scholar who has examined the question, Professor Dennis M. Ray, lists three avenues of influence by which MNCs can affect foreign policy:

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—their capacity to take independent action in the international arena through foreign investment;
—their direct and indirect influence on foreign policy decision-making; and
—their capacity to shape public opinion in such a way as to legitimize governmental action in favor of business interests abroad.¹

This paper will focus on the first of these avenues of influence. It is, then, a study of the effects of MNCs on foreign policy through their economic activities, rather than through their ability to influence the makers of foreign policy, either directly or indirectly through the manipulation of public opinion. The recent Congressional hearings into the extent to which International Telephone & Telegraph (ITT) attempted to influence U.S. policies with regard to Chile is a good indication of the controversy that is likely to be associated with any study of the last two means by which an MNC may affect foreign policy. Admittedly, drawing a line between economic activities and the lobbying efforts which inevitably accompany them is a difficult task at best.

This paper first provides a definition of MNCs and gives an idea of the scope of foreign direct investment (FDI). Next, the economic and political impact of FDI on both the United States (home country) and the host countries is examined. National perceptions of the economic and political effects of FDI are, in turn, important determinants of the foreign investment policies of host countries and the United States, and these policies are briefly discussed. The interaction of these sometimes complementary, sometimes conflicting foreign investment policies demonstrates the impact of FDI on U.S. foreign relations. The conclusion suggests that the ability of MNCs to effect foreign policy through FDI may require some modification of specific U.S. policies affecting foreign investment.

**The Scope of Foreign Investment by U.S. MNCs**

The absence of any generally accepted definition of MNCs is always a problem. This paper defines these dynamic entities in terms of their capability to shift production and resources between different countries and their potential for internationalizing management and corporate outlook. Because this paper is principally concerned with the foreign investment activities of U.S. MNCs,

data covering total American FDI$^2$ is used as an approximation of these activities.

Changes in the size, composition, and geographical distribution of U.S. FDI can be relevant to its effects on our foreign relations. Table I, infra, illustrates the rapid growth of U.S. FDI during the period from 1950-1970, and compares the growth of U.S. FDI with that of trade, GNP, and the investment of other nations in this country. U.S. foreign investment continues to grow and preliminary figures for year-end 1972 place the book value of our worldwide FDI at approximately $94 billion.

Table II, infra, shows the changes in the composition and geographical distribution of U.S. FDI since 1929.

**The Economic Impact of Foreign Direct Investment**

The case for allowing unrestricted FDI parallels the arguments for free trade: the free flow of capital and technology, as well as the free exchange of goods, is believed to result in a more efficient allocation of the world’s resources and an improvement in world economic welfare.$^3$ While impressive, this argument does not say anything about how the economic gains will be distributed. If the gains appear to flow more to the United States than to the host country, or to certain groups within either country and not to others, potential problems lurk for U.S. foreign relations.

**Host Country Economic Effects**

Host country concern over the economic effects of FDI is closely related to the motives of foreign investors in deciding to locate abroad. Stephen Hymer has pointed out that a foreign enterprise, in order to overcome the presumed innate disadvantages of not

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2. The U.S. Department of Commerce defines “foreign direct investment” as a relationship in which “... the U.S. ownership is 10 percent or more when directly, or 25 percent or more when indirectly and directly held ...” U.S. DEPT. OF COMMERCE, SPECIAL SURVEY OF U.S. MULTINATIONAL COMPANIES, 1970, at 15 (1972).

3. Theoretically, the only strictly economic argument for restricting international flows of capital and technology is the argument for an optimal capital tax, analogous to that for an optimal tariff. See Johnson, The Efficiency and Welfare Implications of the International Corporation, THE INTERNATIONAL CORPORATION 43-44 (1970) (hereinafter Johnson).
being a local firm, must bring with it some offsetting asset. 4 Examples of such assets are new technology, access to capital, management skills, an international marketing network, or merely a differentiated product.

The basic economic concern of a host country regarding FDI is thus its assessment of the extent to which the investing firm will be able to appropriate the potential profits associated with its control over some specialized knowledge. If the return on this knowledge is entirely absorbed by the investor, and product and factor prices remain unchanged, there is no direct benefit to the host economy except to the extent that the host government is able to tax these profits.5

If, on the other hand, the foreign investor is not able to appropriate the return completely, there can be significant "spillover" benefits to the host country. These benefits can accrue to labor in the form of higher real wages and expanded employment; to consumers by way of lower prices; to local resource owners in the form of rents; to domestic entrepreneurs through induced investment opportunities (i.e., forward and backward linkages), and to government through increased royalties and taxes. There may be additional external economies from the non-monetary transfer of technology, marketing information and management skills, introduction of new products, and training of local labor.

Recipient countries naturally want to know the extent to which these potential economic benefits from FDI exist. Specifically, they want to know:

—whether the resources transferred are appropriate to host country needs; and, if so, whether they could have been obtained in another manner at a lower cost;
—what the impact of any "spillover" effects of FDI will be on the domestic economy; and
—what effect FDI is likely to have on their balance of payments.

Appropriateness and Cost of Technology

Economists from less developed countries (LDCs) sometimes complain that foreign investors use capital-intensive production processes unsuited to their labor-abundant economies, and that considerable useful technology can be had at little or no cost through foreign assistance programs and academic exchanges. It is a fact that Japan was, until recently, able to base much of its

4. See the discussion in KINDLEBERGER, INTERNATIONAL ECONOMICS (1968) at 390-91.
5. Johnson, supra note 3, at 45.
rapid growth on “second hand” technology acquired through licensing agreements and simple imitation of foreign products rather than reliance on FDI. Yet, as Japan is now discovering, much advanced technology often is only available through FDI.

Effects on Domestic Economy

The potential revenue benefit to the host government has already been mentioned. The effect on competition in the host country economy is more difficult to estimate. If a host country industry is oligopolistic, the entry of a foreign investor may provide a beneficial increase in competition. On the other hand, it has been alleged that if the challenge of the foreign investor is too great, it may stifle the development of a local entrepreneurial class and result in a more or less permanent state of economic dependency.

Of particular relevance to the LDCs is the effect of MNC operations on income distribution. If foreign investment is concentrated in a small, relatively capital-intensive sector, such as is frequently the case in raw materials extraction, a small elite class of skilled workers, managers, local business partners, and government officials may be strengthened. In such cases where FDI has few linkages with the rest of the economy, income inequalities may be increased, unless offset by host government policies.

Comparatively little empirical work has been done to date to try to measure the extent of “spillover” benefits to the host economy. Studies by several economists, however, do tend to indicate that these effects are positive.

Balance of Payments Effects

It is generally recognized that the initial inflow of capital will have a favorable effect on the host country balance of payments.

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9. See, e.g., Caves, Benefits to Host Countries from Foreign Investment, Discussion Paper Number 294, Harvard Institute of Economic Research, Harvard University, 1973. In addition, studies by John Dunning and Donald Brash found that the presence of U.S. MNCs had resulted in increased competition in British and Australian industries respectively.
At the same time, it is contended by some LDC economists that since the reverse flow of repatriated dividends, earnings, interest and royalties in any year usually exceeds the inflow of new capital, FDI is actually decapitalizing their countries. Such arguments fail to take into consideration positive effects of FDI on the host country balance of payments that may result from increased exports or import substitution. Yet, if the host country suffers from low resource mobility or follows suboptimal economic policies (e.g., an overvalued exchange rate and/or high tariffs), the host country may indeed experience a deterioration in its payments balance associated with FDI.

Empirical work on the balance of payments effects of FDI has produced results both pro and con from the host country standpoint. A recent study on the economic impact of MNCs by the U.S. Tariff Commission found that the balance of payments effects of U.S. MNCs in manufacturing varied from country to country, but produced an overall deterioration in the balance of payments of the rest of the world with the United States. Empirical work on the balance of payments effects of FDI has produced results both pro and con from the host country standpoint. A recent study on the economic impact of MNCs by the U.S. Tariff Commission found that the balance of payments effects of U.S. MNCs in manufacturing varied from country to country, but produced an overall deterioration in the balance of payments of the rest of the world with the United States. Other studies have indicated results more favorable to individual host countries, and it would seem almost self-evident that FDI has made an important balance of payments contribution to raw material exporting countries such as Venezuela, Saudi Arabia, Libya and Nigeria.

Economic Effects of FDI on the U.S.

In the United States there has been considerable acceptance of the view that FDI produces a “win-win” situation economically for both the sending and receiving countries. In recent years, however, doubts have been expressed, particularly by organized labor, as to the economic benefits accruing to the U.S. from FDI. Charges are made that MNCs are “runaway industries” which export American jobs and technical know-how to “cheap labor” countries and that present tax laws reduce the potential benefit of FDI to the U.S. Treasury. These accusations are embodied in the Burke-Hartke trade bill currently before the Congress.

While it has by no means settled the argument, the Tariff Commission study provides evidence that the overall economic effects of FDI on the U.S. economy are positive. Specifically, the Commission found that:

11. Id. at 1-14.
the larger American direct investors have tended to be sources of increased U.S. exports;

American FDI produced a modest net increase in our domestic employment, under what it considered to be the most realistic set of assumptions regarding what might have happened had the U.S. investor not gone abroad;

American MNCs have made a positive contribution to the overall U.S. balance of payments (although not with that of every country); and

American FDI has not played a role in narrowing the U.S. comparative advantage in a number of high technology fields.

The Tariff Commission study, of course, does not mean that FDI may not have adverse effects on particular sectors of the economy, as policy makers are frequently made well aware.

Effect on the International Economic System

Both sending and receiving countries have an interest in the impact of FDI on the international monetary and trading relations. It is widely believed that the operations of MNCs frequently promote economic integration, both within a single country and in regional groupings such as the European Community. Less bound by a parochial national outlook than their continental competitors, U.S. MNCs have been effective in exploiting the enlarged market offered by the European Community. In Latin America, the role of the MNC in increasing economic interdependence between nations is evident in the various complementation agreements. Under these accords, several governments, at the request of MNCs or a trade association, will agree to free trade in certain products. In return, the MNCs arrange their production programs in each participating country so that they will be complementary rather than competitive, to those in the others.

U.S.-based MNCs are an important element in the total world trading picture but do not dominate it. The Tariff Commission study found that while the MNC share of world trade increased by 2 percent between 1966 and 1970, they still only accounted for 23 percent of total world exports of over $300 billion in the latter year. Thus, fears that world trade is rapidly becoming intra-

13. See note 10, supra, at 278.
company transfers—and subject to greater manipulation than arm’s length transactions between independent buyers and sellers—appear for the present to be exaggerated.

The ability of MNCs to shift funds rapidly from one currency to another has a major impact on the international monetary and investment policies of the United States and other countries. Of the estimated $268 billion in short-term assets held by the principal public and private institutions in international money markets at the end of 1971, the Tariff Commission study found that about $171 billion or 64 percent was in the hands of foreign affiliates of U.S. corporations or foreign branches of U.S. banks. The $171 billion in short-term international money market assets held by instrumentalities of U.S. MNCs is considerably larger than total world monetary reserves and is virtually uncontrolled by governmental authorities anywhere. Only a small fraction of the funds available to U.S. MNCs and the other participants in the international money market need move in order for a genuine monetary crisis to develop. Undoubtedly, currency movements by MNCs have been a significant element in the recurrent dollar crises which have plagued the international monetary system since 1971. (Corporate treasurers have the responsibility to protect the firms’ assets.) Against this negative factor must be balanced the important creative role of U.S. MNCs in the development of the international money market.14 The long-term solution lies probably not in the investment area, but in the establishment of the kind of international monetary order where destabilizing capital movements are no longer necessary.

The Political Impact of Foreign Direct Investment

The political impact of FDI results from the fact that it is undertaken by firms which, by definition, operate under the jurisdiction of more than one national state. The unique characteristics of MNCs noted earlier—the capability to shift productive operations between different countries and a potential for internationalization of corporate outlook—have given rise to widespread feelings that these firms pose a threat to the full exercise of national sovereignty. While such sentiments probably underestimate the power of the nation state to regulate economic entities within its boundaries, the fears are nonetheless real ones. Since the U.S. is by far the largest investing country, the political as well as the economic impact of MNC operations appears different, depending whether it is seen from a U.S. or foreign viewpoint.

14. Id. at 534-46.
The Foreign Perspective

Foreign governments perceive dangers in U.S.-owned MNCs because of:

— their very size;
— popular “gut” feelings that key domestic industries should be in indigenous hands;
— possible interference by the MNC with domestic policies or avoidance of national planning and regulations; and
— their possible use by the U.S. government as a channel for interference.

Size

It is estimated that the United States supplies roughly one-half of the world’s foreign direct investment and U.S. foreign investors have been hyperbolically characterized as the “world’s third greatest power.” In Canada during the 1960’s, U.S.-controlled companies accounted for about 60 percent of that country’s total output of manufactures, which prompted a remark by Prime Minister Trudeau about the dangers of sleeping next to an elephant. In Europe, the U.S.-owned share of the economies is much smaller. Here tensions are generated when U.S.-controlled MNCs take over established industries, and concentrate in the advanced sectors of the economy. Developing countries, too, worry about the large size of MNCs (not just American) in relation to their fledgling economies.

Gut Feelings

Appeals to national identity and prestige, security, mercantilist economics, ideology, culture, or a combination of these tap the same wellspring of feeling. It follows that it may be politically, even if not economically, desirable to have at least certain sectors of the economy under indigenous control. The development of the Anglo-French “Concorde” is an example of a reaction to U.S. dominance in this high-technology area based largely on prestige, and possibly on national security considerations. These are reactions to MNCs most common in the developed world.

The threat to national culture straddles the developed and the developing worlds. As a leading edge of modernization, MNCs can bring painful disruptions to traditional LDC cultures, as well as a perceived vulgarization of the cultures of developed countries ("la cocacolonisation de France"). The fear that American MNCs will not follow local practices in hiring, firing and operating may also raise concerns.

An ideological objection to MNCs is encountered in Eastern Europe and some LDCs. Growing pragmatism and the need for advanced technology may temper the resistance in Eastern Europe to the entrance of MNCs. Marxian ideology will still play an important role, however, in the form and extent of their operations.

Interference with Domestic Policies

The capability of MNCs to open or close plants in a particular country, manipulate intra-enterprise transfer prices, use differential lags in payments between subsidiaries, and restrict affiliate exports is viewed with concern by national policy makers. A Canadian Government Task Force on the Structure of Canadian Industry, for example, found that the "tendency inherent in direct investment to shift decision-making power in the private sector outside Canada, has, on occasion, posed serious problems for those formulating Canadian policy . . . ". Similarly, in France there was concern that the access of American MNCs to capital outside that country enabled those firms to escape the controls of the planning authorities.17

The ability of MNCs to avoid national economic controls should not be exaggerated. There are real limits to the extent that transfer prices and intra-firm payments can be manipulated in a country with reasonably efficient and honest tax and customs bureaucracies. More importantly, given the possibilities for control open to a host government, ranging from legal penalties to subtle discrimination and even outright expropriation, an MNC is likely to be very cautious about defying important national economic policies.

The potential for MNC interference with domestic policies in developing countries may be somewhat greater than in countries such as France or the United Kingdom, yet even in the LDCs it is certainly less than it was a generation ago. With respect to the

17. KINDLEBERGER, AMERICAN BUSINESS ABROAD 81-83 (1969).
allegations against ITT in Chile, it should be noted that regardless of what may have been considered, the company apparently did not in fact carry out any plan to disrupt the local economy.\textsuperscript{18}

On the other hand, the very flexibility of the MNC allows it to be particularly responsive at times to national policies. In some instances, footloose U.S.-owned MNCs have been more easily able to respond to host government incentives to invest in depressed regions than established local firms. This appears to have been the case in Italy's Mezzogiorno and the Massif Central region of France.\textsuperscript{19}

\textbf{Channel for Interference by the U.S. Government}

Although a number of MNCs may have developed a global perspective economically and commercially, most of them are still basically national in their political outlook. MNCs still rely on the government of the parent company to provide protection against what they consider to be unjust acts of host governments. In return, foreign investors willingly or unwillingly may, on occasion, become an instrument of the home country in the extraterritorial application of its economic policy. In the past, attempted application of our trading-with-the-enemy legislation to U.S.-owned subsidiaries in several countries which were doing business with Cuba and the People's Republic of China, resulted in considerable ill feeling, although the economic magnitudes involved were quite small. A different but related problem with France was caused by a 1964 U.S. government decision to forbid IBM to export some of its advanced computer equipment to its French subsidiary.\textsuperscript{20}

The application of our antitrust laws has also led to complaints by other governments that the U.S. government was interfering in their domestic affairs. Other examples of governmental interference include direct U.S. investment controls, and pressures to speed up remittance of earnings. So important are U.S. direct investment funds to Canada that fears that the flow of American capital to our northern neighbor would be restricted touched off a run

\textsuperscript{18} Benoit, \textit{The Attack on the Multinationals}, 7 \textit{COLUM. J. OF WORLD BUS.} 21 (1972).
\textsuperscript{19} Vernon, \textit{supra} note 8 at 244.
\textsuperscript{20} Id. at 235-36.
on the Canadian dollar in the late 1960’s, even though Canada was in a strong balance of payments position at the time. 21

In theory, there is no reason why the foreign subsidiary of an MNC cannot transmit host country pressures and policies to the United States. In practice, however, the country in which the MNC’s management and/or the largest proportion of its assets are located is probably able to exert the greatest pressure on the company's policies.

The U.S. Perspective

From the earliest days of the Republic, the United States has maintained a policy of welcoming foreign investment. A combination of our dedication to the free enterprise system, our role as pacesetters in modernization, and our pluralistic society embodying traditions from many countries, all have deterred the spread of a view of foreign investors as threats to ideology, traditional values or national identity. It would be interesting, for example, to know how many Americans are aware, or indeed would care, that Shell Oil is a foreign-owned firm. Whether this tolerance would persist in the face of truly large-scale or highly visible investment is open to some question. At present, public concern has concentrated on the economic effects of American MNC operations abroad (e.g. charges of job exportation), rather than political ones.

While its importance thus should not be exaggerated, prejudice against foreigners is nevertheless an obstacle to FDI in the United States. The concentration of foreign ownership in certain areas or sectors of the economy can create resentments here not unlike those sometimes experienced by American investors abroad. The rapid growth of Japanese investment in Hawaii and on the West Coast has been viewed with a certain uneasiness by the local populace and has prompted expressions of concern to legislators and government departments.

Distrust of foreign influence in the U.S. economy is also seen in a bill (H.R. 8951) submitted to the House of Representatives in June, 1973, by Congressmen John Dent and Joseph Gaydos, both from the Pittsburgh area. This proposal, to which observers give little chance of passage, would prevent non-U.S. citizens from acquiring more than 35 percent of the non-voting securities, or more than 5 percent of the voting securities, of any company registered under the Securities Exchange Act of 1934.

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HOST COUNTRY INVESTMENT POLICIES

The economic and political effects of FDI discussed above, or, perhaps more accurately, the perception of these effects by policy-making officials, are important determinants of national foreign investment policies. While many governments appear to acknowledge at least potential economic benefits from FDI there are considerable misgivings with regard to its political impact. These doubts and other domestic political considerations are resulting in increased regulation of FDI by a number of developed as well as developing countries.22

Developed Countries

In developed countries, restrictions on FDI generally take the form of regulations in the sensitive area of takeovers of domestically-owned businesses and the exclusion of FDI from sectors such as banking and communications. Foreign ownership of the economy has become a national political issue in Australia and Canada. Late in 1972, Australia instituted an advance screening requirement for foreign takeovers of locally-owned firms of $1 million (Australian) or more. The screening is to determine whether the foreign investment will bring net benefit to Australia with respect to prices, quality or range of products, and technology sufficient to justify increased foreign control of a particular industry. The new Labor government in Australia came to power in December, 1972, with a platform calling for greater Australian ownership of Australian resources, although to date this has not been translated into specific programs. In Canada, where two government commissions have investigated the impact of FDI, particularly from the U.S., Parliament is considering a Foreign Investment Review Act, which would require official review of foreign takeovers of Canadian firms and perhaps could be extended to new investments later.

The European Community (EC) has not formulated a common policy on FDI, and most questions are handled directly by the nine member governments. The emerging EC programs on anti-

trust policy, regional development, and common industrial policy will all have important implications for U.S. FDI. As presently formulated, the EC industrial policy would accord properly registered European subsidiaries of U.S.-owned firms treatment equal to that of national firms of the member states. France, on occasion, has asserted that firms granted the same treatment as national firms of member states should have their decision-making centered in Europe (and not the home country). It remains to be seen to what extent EC policies will in fact favor European industry at the expense of U.S. foreign investment.

Attitudes toward FDI among the nine members of the EC vary considerably. Ireland actively seeks FDI and offers tax incentives to attract it. France, while host to considerable FDI (including U.S. investment of over $3 billion), has on several occasions opposed takeovers of prestigious or high technology national industries. The other major European countries generally have welcomed FDI, and indeed have encouraged it in hopes of furthering regional development programs. In several countries, however, there have been indications of increasing sensitivity with regard to takeovers.

While still more restrictive to FDI than the United States or most European countries, Japan, following a good deal of urging by its Organization for Economic Cooperation and Development (OECD) partners announced a new and significantly liberalized system of FDI regulation earlier this year to permit 100 percent foreign ownership of new investments in most sectors. Heretofore, Japan had limited most foreign investors to minority participation in joint ventures with Japanese firms.

All told, the actions taken by developed countries strengthen their ability to determine whether specific foreign investments are consistent with fundamental national interests. These policies do not promise to reduce capital and technology flows among the industrialized countries. On the contrary, as Japan's recent liberalized investment policies take effect and as the depreciation of the dollar makes the United States increasingly attractive for inward direct investment, long-term capital flows between the developed countries may well continue to grow.

**Developing Countries**

The policies of developing countries toward FDI range from active recruitment to complete rejection. Among the factors influencing an LDC's attitude toward FDI are its socio-political orientation and its resource endowment. As a group, the LDCs probably have less confidence with regard to the potential benefits of
FDI, which reflects their historical experience with FDI and the paucity of foreign investors based in the developing world.

Few developing nations place no significant restrictions on foreign investment, and a number of LDCs have taken or are contemplating actions to limit it severely. Not content with restrictions on new projects, several LDCs have resorted to expropriation or forced divestiture of existing investments, particularly in the extractive, financial and public utility sectors. Some of these developments reflect domestic political considerations, such as the major reorientation of governmental policies which took place in Chile following the election of President Salvador Allende. Others have specific economic objectives, such as attempts to channel foreign investment into export industries, to shield domestic entrepreneurs from foreign competition, and to obtain a greater share of oligopolistic profits.

The following examples are indicative of the types of limitations which LDCs are placing on FDI:

The Andean Pact

Through a series of decisions made in 1970 and 1971, this group of South American countries (Bolivia, Chile, Colombia, Ecuador, Peru, and soon to be joined by Venezuela) agreed on a foreign investment code which would place FDI under tightened host country control. The code provides that in order to receive the trade liberalization benefits of the Pact, existing foreign-owned firms must divest themselves of sufficient equity over a 15 to 20 year period to bring local ownership of each investment up to at least 51 percent. Foreign investors contemplating new projects in these countries must agree *ab initio* to similar phased disinvestment. The code permits Pact members to impose even stricter conditions on FDI than those required by the code. Some members of the Pact, notably Chile, Peru, Ecuador and Bolivia have done so and have expropriated a number of foreign-owned firms.

The Andean investment code has influenced proposed foreign investment restrictions in Mexico and Argentina. A number of other countries, including Morocco, Ghana, the Philippines, and Thailand have recently announced decrees which will require a changeover to majority domestic ownership of investments in specified sectors of their economies.
The eleven members of the Organization of Petroleum Exporting Countries (Abu Dhabi, Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, and Venezuela) have joined together in a concerted effort to improve their share of the economic benefits from FDI vis-a-vis the foreign-owned international oil companies. While OPEC members have received increasingly favorable terms for new petroleum concessions over the years as a result of nationalistic pressures, major existing concessions for the most part remained relatively unchanged until 1972. Last year, Saudi Arabia and the Persian Gulf states, capitalizing on their position as holders of the world’s largest known petroleum reserves, demanded and obtained equity participation in the producing activities of the concessionary companies. The agreements negotiated provided for immediate 25 percent ownership by the host government which will rise to 51 percent in 1982. Negotiations are underway with other OPEC members and are expected to result in agreements at least as favorable to the host governments. Direct expropriations of foreign oil companies recently have taken place in both Iraq and Libya. In the latter case, the motivation appears to have been to put pressure on the other companies to come to terms and to affect U.S. foreign policy.

The effects of imposing restrictions on FDI of the types discussed are likely to be mixed. In some cases they may stimulate local entrepreneurship, savings, investment, and the development of local capital markets. On the other hand, even selective restrictions may bring about a worsened climate for and net reduction in FDI of all types; divert scarce resources away from areas, such as social infrastructure, which may be less suitable for FDI; and result in an undesirable redistribution of income in favor of domestic capital. When countries resort to uncompensated expropriation, or to discriminatory treatment of FDI already in place, the problems can become escalated into intergovernmental disputes.

In spite of the above, opportunities for mutually profitable business relationships may continue to exist for foreign entrepreneurs even in countries with significant restrictions on FDI. Frequently, the key for the businessman in unlocking these opportunities and for the host government in avoiding a worsened investment climate is the use of new forms of investment such as joint ventures, scheduled renegotiation of contracts, use of buffer institutions for financing, phased disinvestment, and various types of cooperative ventures not involving equity ownership. As long as profit-making opportunities and reasonable stability as to the "rules of the
game” exist, businessmen increasingly appear to be finding the form of their activity to be of secondary importance. Evidence of this can be found in the growing numbers of U.S. and Western European businessmen doing business in the Socialist states, all of which either prohibit, or at a minimum place tight restrictions on, FDI.

**INTERNATIONAL INITIATIVES ON FDI**

Parallel to the attention being given to FDI by national governments, an interest has developed in a number of international organizations. The developing nations—which look at investment issues almost exclusively from the perspective of FDI hosts—want international consideration of the impact of MNCs on their economies and national autonomy. The LDCs have been in the forefront in sponsoring studies of MNCs in several United Nations bodies. These include a United Nations Economic and Social Council (ECOSOC) study on the impact of MNCs on economic development; a United Nations Conference on Trade and Development (UNCTAD) investigation of restrictive business practices, including those associated with MNC activities, which may affect LDC trade and development; and work by the International Labor Organization (ILO) on the relationship of MNCs to domestic social policies. All of these studies are still in progress and have not as yet produced any concrete policy recommendations.

While cooperating with these efforts, the developed countries—most of which are senders as well as receivers of FDI—appear to be more interested in seeking to identify possible areas of common interest in the investment field. The objective is to try to achieve a consensus which will permit the continued flow of capital and technology, with presumed economic benefits, and establish at least some agreed-upon limits regarding national policies to either encourage or restrict FDI. As a result, most of the developed countries, including the United States, have looked principally to the OECD for multilateral discussion of FDI issues. At present, the focal point for OECD activity on FDI is the high-level Executive Committee in Special Session which has recently agreed that proposals should be considered for setting up consultation procedures based on guidelines in matters concerning international investment and the activities of MNCs. Several other OECD com-
mittees are also examining specialized FDI-related matters. The Committee of Experts on Restrictive Business Practices, for example, is currently considering the feasibility of developing a code of behavior for MNCs.

**U.S. Government Foreign Investment Policies**

The basic tenet underlying U.S. foreign investment policy is adherence to the principles that entrepreneurs should be free to respond to market forces, and that government should follow a policy which is basically neutral with respect to FDI. Overall U.S. policy reflects a belief that the economic and political impact of FDI is beneficial to the United States and our foreign relations. The United States government has generally sought to reduce national impediments—including our own—to the free flow of FDI. In furthering this objective, we have supported liberalization of the OECD Capital Movements Code and the international convertibility of currencies; we have entered into a network of bilateral treaties of friendship, commerce, and navigation or of amity and economic relations to secure national treatment for American foreign investors; and through our tax laws and bilateral tax treaties with other countries, we have aimed at having foreign investment income receive neither privileged nor discriminatory treatment.

Despite the general presumption in favor of letting market forces determine investment flows, a number of specific U.S. government policies are exceptions to this rule, some encouraging FDI, others serving to restrict it. These non-neutral policies have come about as the result of ad hoc responses to particular international economic problems, tradeoffs between foreign and domestic economic policy goals, and the influence of non-economic national interests.

Probably the most significant departure from neutrality on the restrictive side is the program of controls over direct investment outflows, voluntary at first and mandatory since 1968, which came about as a response to U.S. balance of payments problems. While the present Administration is committed to ending all remaining controls over FDI by the end of 1974, there is some sentiment in the United States—as evidenced by certain provisions of the Burke-Hartke trade bill—for the enactment of significantly tighter restrictions than presently exist on FDI outflows. The Burke-Hartke bill has received considerable publicity, but there appears to be little likelihood of its being adopted, at least in its present form. It is even more unlikely that the United States will reverse its traditional policy of welcoming inward FDI, although in light of the sensitivities noted earlier, there may be some domestic pres-
sures for discouraging the concentration of FDI in certain sectors or areas.

Other U.S. policies may, or definitely do, encourage FDI. While the proclaimed goal of our fiscal policy is neutrality with regard to whether income is earned either at home or abroad, a number of economists believe that certain provisions of our tax laws, notably the deferral of U.S. tax on the income of foreign subsidiaries of American firms until it is repatriated, actually work to encourage foreign investment. The present Administration has recently proposed elimination of the tax deferral on new FDI where the U.S. entrepreneur goes abroad to take advantage of host country tax incentives or to serve the U.S. market by producing in foreign countries with low corporate income taxes. It has not been proposed, however, to eliminate the tax deferral itself.

The U.S. government actively encourages FDI in those LDCs which seek it. This policy, which is a cornerstone of U.S. policy towards the developing world, is based on the assumption that FDI is a vital contributing factor in the development process and, as such, a necessary complement to official assistance flows. The President's policy statement on "Economic Assistance and Investment Security in Developing Nations" of January 19, 1972, described the link between investment and development in the following way:

A sort of symbiosis exists—with government aid efforts not only speeding the flow of, but actually depending for their success upon, private capital, both domestic and foreign.

Specifically, the U.S. government provides incentives for investing in LDCs by means of the investment insurance and financing programs of the Overseas Private Investment Corporation (OPIC), general exemption of the developing countries from the FDI controls program, and preferential tax treatment. By serving to reduce political risks, OPIC insurance may stimulate the flow of some U.S. investment to LDCs which, absent insurance, would not otherwise go there.

Closely related to the U.S. government policy of encouraging FDI for developmental purposes is the policy of attempting to provide security for that investment once in place. Diplomatic efforts to protect the property of one's citizens from what are regarded as arbitrary acts of other governments have venerable roots
in international law and in U.S. usage. The United States respects the right of other governments to take American-owned private property provided that such actions are non-discriminatory, for public purposes, and that the owners of the property receive prompt, adequate, and effective compensation. Since U.S. foreign investment policy is based on a general presumption that FDI benefits both the receiving as well as the sending country, it calls into question the economic wisdom of expropriatory acts.

The Presidential policy statement already referred to states that when a country expropriates a significant U.S. interest without making reasonable provision for compensation, it should be presumed that the U.S. government will neither extend new bilateral economic benefits to the expropriating country, nor support loans to that country by international development banks...unless and until it is determined that the country is taking reasonable steps to provide adequate compensation or that there are major factors affecting U.S. interests [humanitarian relief efforts, for example] which require continuance of all or part of these benefits.

The same considerations are reflected in the Hickenlooper Amendment to the Foreign Assistance Act and the Gonzalez Amendments to legislation authorizing U.S. contributions to the multilateral lending institutions. These provisions of law do not explicitly give the President discretionary authority to take into consideration other major factors affecting U.S. interests. Accordingly, a potential for conflict exists between the terms of the President's policy statement and the requirements of legislation. As a practical matter, however, it has thus far been possible to avoid this problem.

THE INTERACTION OF NATIONAL FOREIGN INVESTMENT POLICIES

The foreign investment policies of the United States and other nations sometimes mesh and sometimes clash. Most developed countries have adopted policies which are consistent with a reasonably free international flow of capital and technology. As a result, major disputes with these countries over American FDI have been largely avoided. The occasional disputes with France on investment-related matters are one notable exception, and new

23. As this article is being written (October 1973) it appears that the 1973 Foreign Assistance Bill may emerge from the Senate-House Conference Committee with a provision regarding the expropriation of American property which is more explicitly consistent with the language of the President's policy statement. This would not affect the Gonzalez Amendments, however.
regimens for FDI in Australia and possibly Canada may be cause for some concern in the future.

While American FDI continues to grow in the developing world, investment-related foreign relations problems seem to be increasing at least as rapidly. United States government policies to encourage FDI, and then to protect it once in place, can conflict, and have done so, with LDC policies aimed at restricting foreign investment. Take the following, unfortunately not hypothetical, example:

The U.S. government, consistent with its commitment to LDC development, encourages American FDI in a particular country thought to have a favorable climate for foreign investment. Then, as the result of a change in government, the socio-political orientation of that government undergoes a major change. The new government adopts policies greatly reducing the role of FDI in the economy, which give rise to disputes over compensation with the foreign investors whose property is being taken. This, in turn, calls into play U.S. policies to protect the rights of our investors overseas. These policies grate on LDC sensitivities as has been particularly evident in Latin America. The result: where the U.S. government once sought to aid the country's development by encouraging FDI, it now finds that our investment security policy demands serious consideration of halting bilateral assistance flows, and possibly requires, by law, automatic opposition to new multilateral lending to that country. Ironically, FDI, the presumed agent of constructive international economic relations, can, on occasion, become a major source of tension between the United States and other countries.

**Some Questions for Current Policy**

It is appropriate to conclude with a mention of some of the implications of U.S. foreign investment policy. Four questions suggest themselves:

First, should the United States continue to press vigorously for further relaxation of national restrictions on FDI? While undoubtedly desirable from a strictly economic viewpoint, such a course of action could be counterproductive politically, given the evidence of considerable and apparently increasing misgivings regarding FDI
on the part of a number of developing and some developed nations. A more realistic policy, under present circumstances, might well be to concentrate on persuading the developed countries to comply more fully with the provisions for liberalizing capital movements already agreed to, and the LDCs to recognize that maintaining relatively stable, consistent policies toward FDI can help to improve a country's investment climate and avoid intergovernmental disputes. In view of American concerns about "runaway industries," there may be domestic political pressures for not pushing ahead too quickly in the area of liberalizing national foreign investment policies. At the same time, we should continue to point out, at home and abroad, the economic benefits which can be derived from FDI, and continue to base our overall foreign investment policy on a belief that market forces should be the primary mechanism for determining investment flows.

Second, should the United States still encourage FDI in developing countries? Current U.S. policies probably do mean some net increase in the flow of FDI to the developing world and tend to improve the competitive position of American business abroad. It is not clear, however, how much additional investment is thereby generated, and since the principal incentive, OPIC programs, is not available in all LDCs, the main effect of the incentives may be the distribution of FDI among, rather than on the amount allocated to, the developing nations. It is entirely possible that an appropriate amount of FDI would take place in the absence of incentives as a result of market forces. Likewise, it has not been established that U.S. firms would not be able to compete effectively without OPIC-type programs, or that OPIC plays a significant role in defusing or resolving investment disputes. Of course, there may be some instances where the existence of incentives is crucial to a decision on whether or not to invest. Only where that is the case and where specific national interests, such as developing sources of scarce raw materials, are demonstrable does direct U.S. governmental encouragement of FDI appear to be justified.

Third, is current U.S. policy of seeking to protect our existing investments abroad, including the threat of withholding economic benefits, really effective and consistent with our overall foreign policy interests? Given the strong American tradition of protecting the rights of our citizens, it is most improbable that the United States government could accept a Calvo Doctrine-type policy of giving up the right to make diplomatic representations on behalf of its firms. Yet, it must be recognized that there are real limits to the effectiveness of a policy which relies to a considerable
extent on a threat of sanctions. Withholding economic benefits is
not effective where there is no foreign aid program, nor is voting
against a loan in an international development bank effective if
the United States is isolated in its position and our support is not
required for approval. Such policies work only where there is
some available leverage and as a result, there is a danger of being
able only “to hurt the ones you love.” Yet, the U.S. government
can hardly fail to respond to expropriatory acts by other govern-
ments. On occasion, American firms have indicated that U.S. gov-
ernmental involvement in an investment dispute has been helpful.
Even in such cases, however, we do not always know the extent
to which our success was based on market forces, the threat of
sanctions, the use of our “good offices,” the presence or absence
of OPIC, the desire of the other country to maintain good rela-
tions, or a combination of these factors.

Since expropriations are undertaken for domestic political, so-
cial, and cultural motives, as well as for economic reasons, the
threatened or actual loss of economic benefits may well only be a
secondary consideration in the eyes of the expropriating country.
Consequently, an expropriation policy relying to a significant ex-
tent on the threat of sanctions may only serve, in some cases, to
exacerbate already difficult situations. In addition, American busi-
nessmen, the supposed principal beneficiaries of our investment se-
curity policy, have voiced concerns that the Hickenlooper and Gon-
zalez Amendments can be damaging to their interests.24

The foregoing illustrates the desirability of following an expro-
priation policy, which includes possible withholding of economic
benefits, but which allows for careful consideration of the likely ef-
fectiveness of sanctions before applying or threatening to apply
them. Such a policy would require the repeal or significant lib-
eralization of the Hickenlooper and Gonzalez Amendments, and a
most judicious implementation of the President’s 1972 policy
statement on investment security.

Finally, what are the prospects for international regulation of
FDI? Do, in fact, the operations of MNCs seriously threaten the
existence of the nation state as suggested by the title of Raymond
Vernon’s book, SOVEREIGNTY AT BAY? On the contrary, increased

24. Swansbrough, The American Investor’s View on Latin American
Economic Nationalism, 26 INTER-AMERICAN ECONOMIC AFFAIRS 72-78 (1967).
national restriction of FDI and the skeptical attitudes of many LDCs and even some developed countries toward it may well indicate that the MNCs are the ones at bay. Nation states have shown a remarkable viability and vitality. Stephen Hymer and Robert Rowthorn have implied that if one were to bet on the relative staying power of France and General Motors, the smart money would be on France.25 Given this situation, it is probably realistic to assume that for the present, control over FDI will continue to be exercised primarily at a national, or, in some cases (e.g., the European Community), a regional level. Nevertheless, it may be possible, among the developed countries at least, to achieve some agreed guidelines on permissible limits of national policies which affect FDI. The OECD has made some tentative steps in this direction, and these should be encouraged. The working out of a common policy in the sensitive area of takeovers, which has been suggested by former Assistant Secretary of State Anthony Solomon, could be particularly useful.26

Between the developed countries and the LDCs there appears to be even less likelihood of achieving any significant international agreement on foreign investment policies. While the studies on MNCs under way in the various United Nations agencies may produce new information and provide a forum for exchanging opinions, agreement on anything like a “GATT for investment” does not appear to be in the cards anytime soon.

This analysis should not be interpreted as reflecting pessimism as to the future of FDI. This writer has very little doubt that FDI by MNCs will continue to increase in the coming years. At the same time, the growth of FDI will increase its potential foreign affairs impact. Modifying U.S. government foreign investment policies along lines suggested could reduce the chances of FDI having negative effects on our foreign relations, and help insure that the foreign investment activities of American MNCs continue to play a positive role in the world economy.

<table>
<thead>
<tr>
<th>Economic Indicator</th>
<th>1950</th>
<th>1960</th>
<th>1970*</th>
<th>Average Annual Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. exports (f.o.b., merchandise)</td>
<td>10.3</td>
<td>20.6</td>
<td>43.2</td>
<td>7.2 (1960-1970) 7.6 (1960-1970)</td>
</tr>
<tr>
<td>U.S. imports (c.i.f., merchandise)**</td>
<td>9.6</td>
<td>16.4</td>
<td>42.5</td>
<td>5.5 (1960-1970) 10.0 (1960-1970)</td>
</tr>
<tr>
<td>GNP of industrial countries*** (including the U.S.)</td>
<td>449</td>
<td>873</td>
<td>1,923</td>
<td>6.8 (1960-1970) 8.2 (1960-1970)</td>
</tr>
</tbody>
</table>

* Preliminary.
** U.S. imports are reported c.i.f. to facilitate comparison with foreign import figures. The difference between f.o.b. and c.i.f. valuation is roughly 9 percent, or 10 percent of f.o.b. values.
*** The United Kingdom, Canada, Japan, France, Germany, Belgium, the Netherlands, Italy, Sweden, and Switzerland.

### TABLE II

Growth of U.S. Direct Investments Abroad, by Area and Industry 1929-1970*

<table>
<thead>
<tr>
<th></th>
<th>Amount in Billion Dollars</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Areas, Total</td>
<td>7.5</td>
<td>11.8</td>
</tr>
<tr>
<td>Canada</td>
<td>2.0</td>
<td>3.6</td>
</tr>
<tr>
<td>Latin America</td>
<td>3.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Europe</td>
<td>1.4</td>
<td>1.7</td>
</tr>
<tr>
<td>Middle East &amp; Africa</td>
<td>0.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Other Areas</td>
<td>0.5</td>
<td>0.9</td>
</tr>
<tr>
<td>Developed Countries, Total</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Less Dev. Countries, Total</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>International, Unallocated</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>All Industries, Total</td>
<td>7.5</td>
<td>11.8</td>
</tr>
<tr>
<td>Mining and Smelting</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Petroleum</td>
<td>1.1</td>
<td>3.4</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Other</td>
<td>3.4</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Notes: Detail may not add to totals because of rounding.
- * Book value at year/end
- ** Preliminary
- *** Excludes Eastern Europe
- n.a. Not Available