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I. Foreign Direct Investment as a National Issue

Foreign direct investment (FDI), which provides investors from one country a controlling interest in an enterprise in another nation, has recently emerged as a controversial topic in the United States. Congressional committees which prepared the 500-page Omnibus Trade Bill of 1988 gave close scrutiny to this FDI phenomenon, and included provisions in the final legislation which significantly strengthen Washington's hand in controlling future FDI activity.

FDI has been pouring into the United States, increasing from 13 billion dollars in 1970, to 83 billion dollars in 1980, to approximately 300 billion dollars at the end of 1988. The United States now ranks as the number one host nation for FDI, with a huge gap separating it from the number two host nation, Canada. The issue of FDI is a highly emotional one as people begin to worry about the maintenance of national economic sovereignty in the face of an apparent onslaught of foreign investors. In their widely publicized book, *Buying into America*, Susan and Martin Tolchin warn that the heavy reliance on FDI and foreign portfolio investment is a threat to America's economic and political independence.[1] The popular media has emphasized over and over again that more than three million Americans work for foreign-controlled enterprises, with the Japanese providing 5% of all civilian jobs in Alaska and foreign investors responsible for 12% of the jobs in Delaware. Many people are also

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1. M. Tolchin & S. Tolchin, *Buying into America* 259 (1988). Portfolio investment may be defined as an investment in Treasury bonds, securities, certificates of deposit, etc., which does not provide the investor with a controlling interest in the institution in which the investment is made.

aware that 46% of the commercial property in downtown Los Angeles is foreign-owned, that 39% in Houston is foreign-owned, 32% in Minneapolis, and 19% in Denver.[2] Japanese investors alone own more than one-half of the sixty largest hotels in Waikiki. Foreigners also control over one-half of the U.S. cement and consumer-electronics industries, four of the ten largest chemical companies, and a rapidly expanding percentage of the machine-tool and book-publishing industries. Foreigners have title to over 1.5 trillion dollars in assets in the United States, with 20% of U.S. banking assets now in foreign hands.[3] More foreign-owned firms now manufacture automobiles in the United States than American-owned companies; and such well-known "American" companies and products as Baskin-Robbins, Carnation, Geritol, Spiegel, Alka-Seltzer, Bloomingdale's, Saks Fifth Avenue, and Firestone are foreign-owned.[4]

The editors of *Business Week* insist that Japanese investment activity in the United States must be watched very closely. They warn that "Japanese influence is more pervasive, more visible, and much larger than that of other countries, including Israel."[5] They add that "more to the point, Japan is an economic adversary in a way that no other country is. Watching a foreign competitor manipulate our levers of power so adroitly is discomfitting."[6] Former CIA Director William Casey also bluntly stated that Japanese investments in the American high-technology sector are "Trojan horses."[7]

Because of direct pressure from Washington, the Japanese firm Fujitsu withdrew its bid to acquire Fairchild Semiconductor, even though Fairchild was already controlled by a foreign investor, Schlumberger of France. The 1988 Omnibus Trade Bill (Trade Bill) contains a provision which permits the President of

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2. This information is based on a Coldwell Banker study. *See* ECONOMIST, Aug. 29, 1987, at 70.

3. Wall Street J., Apr. 7, 1988, at 1, col. 5.

4. The U.S. Department of Commerce considers that a direct investment has been made if a foreign firm or individual controls 10% or more of the voting stock of a publicly-traded company. In rare circumstances, this condition may be met, but the foreign investor may still have a subordinate voice in the firm's decision-making process. For example, Seagram of Canada purchased a 23% stake in EI du Pont de Nemours, but the du Pont family continues to control the firm. In most cases, however, a 10% stake is adequate to take effective control of a firm. A vast majority of recent FDI activity has involved 50% or greater foreign ownership.

5. *The Proper Response to Japan's Influence*, BUS. WEEK, July 11, 1988, at 112.

6. *Id.*

7. N.Y. Times, Dec. 29, 1985, at 18, col. 3.

the United States to block any foreign acquisition of a U.S. firm which might conceivably threaten U.S. political and economic security. Prior to the Trade Bill, the President could only block a foreign acquisition by declaring a national emergency under the Emergency Economic Powers Act.

Another provision in the Trade Bill, known as the Bryant amendment, would have required the disclosure of very sensitive financial information from current and future foreign investors in the United States. This amendment was dropped from the trade bill during the conference stage. The amendment was reintroduced immediately after the new Congress convened in January 1989, however its passage is unlikely.

In marked contrast to the commotion caused by FDI at the federal-government level in Washington, D.C., state and local governments (subnational) are quietly spending hundreds of millions of dollars each year in an effort to attract this investment from abroad. Approximately two-thirds of the American states have opened almost ninety offices abroad for trade and investment purposes. Indeed, more American states maintain offices in Tokyo than in Washington, D.C.[8] At least forty-five governors also directed at least one mission abroad over the past eighteen months in search of new direct investment and export opportunities. These leaders of subnational governments are willing to shell out huge amounts of money to attract the very investors that are now viewed so warily by some national leaders and by the media.

This paper will examine why subnational governments in the United States are so intensely interested in FDI, what programs have been put in place to attract this investment, and what the repercussions may be for the national economy and for future intergovernmental relations.

II. State and Local Governments as Players in the International Economic System

The thirty-five states which have now opened offices overseas represent a nearly ten-fold increase since 1970. Forty-eight of the fifty states have substantially increased their international budgets over the past half-decade, and international trade and investment missions are annually sponsored by almost all of the states and territories. Scores of municipalities are also involved

8. Hoffman, *Overseas Sales Pitch*, 1988 Nat'l J. 129.

in the international investment game, hoping to duplicate the experience of Spartanburg, South Carolina, a medium-sized city which has attracted over forty foreign firms and in excess of one billion dollars in direct investment during the past fifteen years.[9]

Why have state and local governments become so integrally involved in the international economic system? Motivation for reaching beyond national boundaries may be explained by the following factors.

The leaders of subnational governments are now acutely aware of the influence which international actors such as foreign governments, state-owned oil companies, or multinational corporations can have on the economic well-being of their constituencies. An OPEC decision to cut oil production, a European Community edict to reduce soybean imports or to raise export subsidies for agricultural products, or a British Petroleum decision to vastly increase its direct investments in a particular country can have a dramatic effect on local and regional economies. More than three million jobs are directly linked to FDI activity, and another four million are dependent on export activity.

In addition, economic development prospects may differ dramatically from one subnational government to the next. The per capita income in Connecticut is more than twice that of Mississippi.[10] Nationally, 14 of every 100 Americans live in poverty, but in West Virginia, the rate jumps to 22 per 100. Several of the Western states are also predominately owned by the federal government, with federal ownership ranging from 30% in Montana to 86% in Nevada. A former Governor of Montana once described the five "human resource" problems of states in his region: (1) out-migration of working people, (2) a resulting small return on large educational investments, (3) a burdensome per capita tax load attributable to sparse populations and vast spaces, much of which is owned by the federal government, (4) a "colonial" status imposed by out-of-state control of an almost purely extractive economy, and (5) the commercial disadvantage of being far away from major markets.[11]

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9. Spartanburg's experience is discussed in E. Fry, Financial Invasion of the U.S.A. 131-34 (1980).

10. The 1987 per capita income in Connecticut was $20,980 compared with Mississippi's $10,204.

11. These comments were made by former Governor Forrest Anderson. *See* J. Hagstrom, Beyond Reagan 76-77 (1988).

Over the past several years, the economic development rate of the Atlantic and Pacific coast states has doubled that of the interior states. In particular, those states which are heavily dependent on agriculture, resource extraction, and traditional industries have suffered major economic upheavals. Consequently, the United States was successful in creating almost three million net new jobs in 1987, many of which were "bicoastal" employment opportunities, but during the same period Dallas, Texas lost 39,000 jobs and several Mountain and Plains states experienced a net out-migration of workers.[12] In the spring of 1988, thirty U.S. counties had jobless rates above 25%, and 100 had rates above 15%. Far too often a vicious cycle occurs in these high unemployment areas. A lack of jobs reduces the tax base; a shrinking tax base hurts schools and other community services; and problems with the educational system diminish the chances of attracting new industries and jobs.[13]

Most U.S. political leaders at all levels of government are also united in their quest to be reelected. In most elections, economic or "pocketbook" issues are foremost on the minds of the voters, and an incumbent's chances for reelection are usually dependent on the economic fortunes of his or her constituency. Through successes in the areas of reverse direct investment, trade, and tourism, American subnational governments can create new jobs, diversify their economic base, and expand tax revenues, all of which should boost the electoral fortunes of government leaders.

Moreover, many subnational units have learned that heavy reliance on the transfer of revenue from the national government can be precarious. The push for smaller budgetary deficits at the national level has dramatically slowed the flow of funds from Washington, D.C. to the state capitals and major municipalities, with one-third less money (in real terms) available in 1988 than in 1980. As a percentage of state and local government outlays, federal assistance dropped from 25% in 1981 to 19% in 1987, prompting one critic to label intergovernmental relations as "fend-for-yourself federalism."[14] When permissible, these

12. In 1987, eight of the ten most robust economies were found in coastal states, and the other two, Arizona and Nevada, depended on California for much of their growth. *See* Hyatt, *Coast to Coast*, INC., Oct. 1987, at 76-77.

13. *See* Wall Street J., Apr. 21 1988, at 1, col. 6.

14. Weinstein & Grass, *States Given Leeway for Low Income Tax*, Wall Street J., Oct. 29, 1987, at 26, col. 3.

subnational units have naturally looked for their own revenue sources and are increasingly going abroad in search of trade, investment, and tourism exchanges.

With an expansion of subnational government services and a decrease, in real terms, of transfer payments from the national governmental level, it is not surprising that many subnational units would be scurrying for new revenue sources. This quest is vitally important, because unlike the federal government, most state governments are constitutionally required to submit balanced budgets each and every year. In 1987, thirty-three states raised taxes and twenty-four cut budgets in order to comply with balanced budget requirements. Twenty-eight states have also instituted lotteries and many permit parimutuel betting in an effort to increase state revenues. With subnational governments now spending in excess of 750 billion dollars annually, business expansion and new jobs are viewed as providing the optimal remedy for revenue enhancement. Consequently, representatives of subnational governments are criss-crossing the nation and the globe in search of new business opportunities.

Constitutional ambiguity and governmental practices have also worked in favor of subnational involvement overseas. In the U.S. federal system, governmental authority is constitutionally divided among the national and state governments. This provides the states with their own constitutionally-derived spheres of authority or reserved powers. Since what is not enumerated as being within the sphere of competence of Washington, D.C. *automatically* reverts to the purview of state government, a fair amount of discretionary authority can often be assumed by these subnational units. In addition, Washington's own laxity in interpreting what subnational units can or cannot do in terms of international commerce, or in entering into binding international contracts and agreements, further clouds the issue of subnational competence abroad and of central-regional policy coordination at home.

III. An Explanation for the Surge in FDI Activity in the United States

State and local governments are vigorously pursuing FDI, but this is only one reason among many for the tremendous upsurge in FDI activity in the United States. On the whole, FDI is occurring for perfectly logical business reasons.

A. *Access to the World's Largest Market*

In spite of facing some major economic difficulties, the United States continues to have the largest, best integrated, and most affluent marketplace in the world, accounting for one-fifth of global production and being home to 245 million consumers. With the implementation of the new Canada-U.S. Free-Trade Agreement, this market will be expanded to 270 million consumers, permitting relatively open access to the number one and number seven ranked economies in the world. It is logical that as foreign-based multinational firms have expanded, they will want a piece of the action in this huge marketplace.

B. *Favorable Exchange Rates*

The decline in the value of the dollar has given many foreign currencies extra purchasing power within the U.S. market. As a concrete illustration, Marks and Spencer of the United Kingdom paid 750 million dollars for Brooks Brothers in 1988. At the exchange rate of 1.86 dollars to a pound when the transaction was completed, this deal cost the British firm around 400 million pounds. Three years earlier, when the exchange rate stood at 1.10 dollars to a pound, the transaction would have cost 682 million pounds. The dollar's decline has provided excellent opportunities for foreign companies to penetrate the American market. However, the foreign companies must always be concerned with the repercussions of a dollar which could continue to fall vis-à-vis their home currency, thus resulting in foreign exchange losses.

C. *Attractive Equity and Land Values*

The increase in equity values on Wall Street has not kept pace with the rise in the stock markets in most other advanced industrial societies. In addition, equity valuation and price/earnings ratios on the New York, American, and NASDAQ exchanges are far below those in Japan and in several other foreign markets. Foreign investors can thus take advantage of two phenomena—a relatively inexpensive dollar and, in comparative terms, a cheaply-priced stock market.

Commercial, residential, and farm properties have the same attraction. At current exchange rates and real estate prices, the total value of Japan's real estate is nearly four times that of the real estate in the United States, even though Japan is only about the size of Montana. In the eyes of many Western European and Japanese citizens, the United States is on sale at bargain basement prices. Unfortunately, the rush of Japanese investors to buy residential property on Oahu has recently prompted the Mayor of Honolulu to ask the state legislature to prohibit foreigners from buying such property, insisting that the rapid increase in housing values has made it virtually impossible for most Hawaiians to buy homes.

D. *Consumer's Paradise*

Using the purchasing power parity (PPP) index which factors out fluctuations in exchange rates and provides a good indication of what the average paycheck will buy in terms of a "basket" of goods and services, Americans still have more purchasing power than the citizens of any other nation. In addition, the United States is not a nation of savers, with less than four percent of disposable income put into savings in 1987, the lowest rate since 1947. This compares to double-digit savings rates in Japan and most of Western Europe. Foreign companies thus face the envious task of selling their products in an affluent marketplace composed primarily of hyperactive spenders.

E. *Unilingualism*

Multinational firms are at home in a variety of cultures and linguistic communities. Nevertheless, the ease and economic benefits of doing business in one language in what is the fourth largest nation in the world, both in terms of land mass and population, has not been overlooked by these foreign enterprises. In contrast, there are nine major languages in the European Community which encompasses an area smaller than the continental United States.

F. *Cheap and Secure Energy and National Resources*

The United States is both energy and resource-rich, especially in comparison to Japan and Western Europe. Foreign investors establishing enterprises in the United States know that they will be able to obtain reliable energy sources and many raw materials at extremely competitive rates.

G. *Research and Development Facilities*

Another attraction for would-be foreign investors is the American universities and research laboratories which are among the best in the world. The Japanese, in particular, have entered into long-term agreements with such noted research centers as MIT, UC Berkeley, and Columbia University. These firms want to remain on the cutting edge of technology, and they still consider that the United States offers many advantages in R & D not found elsewhere.

H. An Impressive Infrastructure

Some parts of America's infrastructure are in drastic need of renovation, but on the whole the foreign-investment community is pleased with the U.S. transportation and communications systems. It is relatively easy to take orders, receive supplies and ship goods to market, and remain in touch with clients and with colleagues at home and abroad.

I. A Reliable and Trained Work Force

Although American workers are often disparaged when compared with their Japanese counterparts, most foreign investors are pleased with the quality of the U.S. work force. These employees generally have adequate educational backgrounds and lack the militancy of workers in other parts of the world. Work stoppages due to strikes are very low in the United States when compared with many other industrialized countries. Moreover, even though the United States is aging as a society, the demographics of working age versus retirement age population are much more favorable than in Japan and in some Western European countries. The shift in the value of the dollar has also reduced unit labor costs in manufacturing to levels below those found in Northern Europe and about even with those in Japan.

J. A Modest Tax Burden

The maximum U.S. personal income tax is now at its lowest level in several decades, falling from 70%, in 1980, to 28% in 1990. In addition, corporate taxes are appreciably below those in most other nations which belong to the Organization for Economic Cooperation and Development (OECD).

K. The Lack of Red Tape

In spite of the provision added to the Omnibus Trade Bill permiting the President to veto foreign acquisitions of certain American companies, foreign firms have experienced relatively few problems in making investments in the United States. The official position of the U.S. Government is to welcome foreign investment based on market forces. State and local governments have also put the welcome mat out for most investors. In addition, the foreign-investment community takes comfort in the stability of the U.S. economic and political systems and the relative lack of governmental interference in the economic sector.

L. *Insurance Policy Against Protectionism*

Overseas investors fear that protectionist skirmishes pitting the United States against Japan, the European Community, or the East Asian Newly Industrializing Countries (NICS), might limit their access to the U.S. market through traditional export routes. FDI provides them with a way to become established within the U.S. market as a precaution against new bouts of trade protectionism. The consequence of voluntary restraint agreements and related trade restraints was certainly a major reason for Honda to proceed with a 1.7 billion-dollar investment in Ohio, Mazda with a 568 million-dollar investment in Michigan, Mitsubishi with a 350 million-dollar investment in Illinois, Nissan an 850 million-dollar investment in Tennessee, Subaru-Isuzu a 500 million-dollar investment in Indiana, and Toyota an 800 million-dollar investment in Kentucky.

M. *The Safe Haven*

Some FDI and even more portfolio investment is entering the United States because of its attractiveness as a safe and secure place to put money, buy land, and build facilities. Unfortunately, tens of billions of dollars have entered the United States from developing nations, nations which have desperate need of new investment activity but which have not gained the confidence of their own investment communities.

N. *The Incentive Game*

State and local governments now provide hundreds of millions of dollars annually to foreign investors willing to start businesses and hire Americans within these governments' areas of jurisdiction. Honda received 70 million dollars from Ohio, Volkswagen 70 million from Pennsylvania, Nissan 66 million dollars from Tennessee, and Toyota an estimated 325 million dollars from Kentucky over the twenty-year life of the incentive package. The incentive game now being played by subnational governments is a costly business, but it is just one reason among many for accelerated FDI activity in the United States.

IV. The Issue in Perspective

What are some of the alleged problems associated with accelerated FDI activity in the United States and how should these problems be viewed by the American people?

A. *Foreigners Exert Too Much Influence Over the U.S. Economy*

Foreign firms, individuals, and governments had about 300 billion dollars in FDI in the United States at the end of 1988, and controlled 1.5 trillion dollars in assets. The foreign influence is certainly growing, with overseas residents accounting for 9% of total U.S. mergers, acquisitions, and leveraged buy-outs (LBOs) in 1987, and 25% of the dollar value of such transactions.[15] This figure undoubtedly increased in 1988.[16]

Nevertheless, this foreign activity from overseas represents a relatively small part of the huge U.S. economy. In 1986, foreign-controlled enterprises accounted for 12.1% of all business assets in the United States, 3.5% of all civilian employment in the non-banking sectors, and 7.8% of all manufacturing employment.[17] In 1987, foreign investors controlled 10% of the U.S. manufacturing base.[18] Moreover, in its own right, the United States is the world's largest foreign investor with 309 billion dollars in FDI in 1987. Because American investors have generally had their holdings abroad for a much longer period of time than their foreign counterparts have had their holdings in the United States, this 309 billion dollars greatly understates the true market value of America's FDI.

The U.S. Government should certainly have the right to protect sensitive economic sectors, and based on this premise, the provision in the 1988 Omnibus Trade Bill which permits the President to veto foreign acquisitions for national security rea-

15. *The 11 Largest Foreign Investments in the U.S.*, FORBES, July 25, 1988, at 240.

16. The Congressional Economic Leadership Institute has estimated that foreign buyouts represented roughly 20% of all mergers, acquisitions, and LBOs completed in 1988.

17. Howenstine, *U.S. Affiliates of Foreign Companies: Operations in 1986*, SURV. OF CURRENT BUS., May 1988 at 59, 63.

18. CONGRESSIONAL ECONOMIC LEADERSHIP INSTITUTE REPORT, July 1988.

sons has merit. If used judiciously, this provision will provide the President some flexibility not found in the cumbersome Emergency Economic Powers Act. On the other hand, the White House might be tempted to use this new authority to win political points with special interest or regional groups, or to veto takeovers for parochial or xenophobic reasons. This would be a gross misuse of presidential power and would likely provoke retaliation from America's major trading partners.

The Bryant amendment should continue to be rejected because it openly discriminates against foreign investors in the disclosure of sensitive business information. Overseas investors should be entitled to national treatment within the United States, and U.S. investors should be accorded the same treatment abroad.

Foreign investors must also be much more sensitive to the impact which they may have on specific business sectors or local communities. The complaint lodged by the Mayor of Honolulu cannot be dismissed out of hand. Nevertheless, many local residents in San Francisco, Los Angeles, Boston, New York City, and Washington, D.C. have also been priced out of local housing markets because of escalating home values, caused predominantly by American investors. Consequently, the plight of Honolulu's residents may not be much different from that of residents in several mainland cities, with the problem linked not to foreign investment, but rather to too many potential buyers chasing too few housing vacancies.

In many ways, the United States is now getting a dose of what it handed out to the Europeans and Japanese during the 1950s and 1960s. Investment is pouring into the United States for logical business reasons, just as U.S. investment poured into Europe and Japan in order to give American firms a solid foothold in what were expected to be expanding economies. U.S.-based multinationals have certainly taken advantage of these post-war FDI opportunities, with American companies in Japan, for example, producing and selling 80 billion dollars worth of goods in 1985.[19] Currently, one-fifth of all U.S. merchandise imports are produced by American companies abroad.[20]

The inflow and outflow of investment is cyclical, based on

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19. The Cuomo Commission on Trade and Competitiveness, A New American Formula for a Strong Economy 58 (1988).
20. Harper's, July 1988, at 15.

the relative attractiveness or lack of attractiveness of individual markets. Today, America is an extremely attractive investment haven for the global business community. In the future, other countries will become very attractive, prompting both foreign and U.S. investors to rush to their borders.

B. *Foreigners Flex Too Many Muscles in the U.S. Political System*

In their book, *Buying into America*, the Tolchins give several examples of representatives of foreign firms exerting pressure on local, state, and national political leaders.[21] It is well documented, for example, that Toshiba urged local and state leaders, in areas where it has American facilities, to contact their members of Congress and persuade them to water down the proposed trade sanctions against the Japanese firm. Toshiba's employees in the United States also embarked on a letter-writing campaign in an effort to sway congressional opinion. Akio Morita, the CEO at Sony, was also instrumental in convincing Indiana's political leaders to scrap unitary taxation. When an Oklahoma representative voted in favor of the Omnibus Trade Bill, an editorial in the *Daily Oklahoman* criticized his vote, warning that "don't be surprised if Oklahoma doesn't land another Hitachi plant right away."[22]

Without a doubt, representatives of subnational governments are sensitive to the demands made by business leaders. The opinions of these local leaders are also given strong currency in the corridors of Congress. Nonetheless, it is natural that local and state political leaders would respond to the needs of their business community, whether the businesses are locally-owned, nationally-owned, or foreign-owned. As an illustration, the *Daily Oklahoman* may have lodged a similar complaint against the member of Congress if he had acted against Oklahoma's economic interests by voting in opposition to placing a duty on imported oil. In certain cases, responding to a complaint made by a foreign-owned company might actually bring down protectionist barriers, such as Indiana's former unitary taxation policy. On the other hand, the response may be simply to protect the skin of a locally-based firm, such as in the

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21. M. TOLCHIN & S. TOLCHIN, *supra* note 1, at 110-128.

22. Mason, *Hitachi's Winning Friends & Influencing People in Oklahoma*, BUS. WEEK, July 11, 1988, at 74, 75.

case of Toshiba's U.S. affiliates. In overall perspective, foreign enterprises remain a very small part of the vast American business community, and PACs formed by overseas companies made a relatively modest 2.4 million dollars in contributions to congressional campaigns in 1986.[23] As long as the foreign-based firms abide by U.S. lobbying and campaign contribution laws, they should be entitled to exert their influence. American enterprises have engaged in similar activities abroad for many decades.

C. *America Is Too Vulnerable to the Demands of Foreign Investors*

Foreign central banks have recently purchased over 100 billion U.S. dollars a year in an effort to prop up the flagging dollar and to help finance American's twin budget and trade deficits. Foreigners now hold about twenty percent of the U.S. Government's debt. When debt-servicing payments are combined with the repatriation of profits and dividends which will accompany increased FDI activity in the United States, Americans can anticipate a sizable outflow of funds over the next several years. These deficits are extremely troublesome, but they are mostly attributable to a 2.8 trillion dollar national government debt, to chronic U.S. merchandise trade deficits, and to an American society which is consuming more than it is producing and saving only four percent of its disposable income.

Without any doubt, the United States is experiencing a growing dependence on foreign governments, corporations, and individuals who have been willing to finance both the government and trade deficits. Unless these deficits are handled effectively, foreigners will begin to withdraw their support in the vitally important U.S. Treasury, exchange, and equity markets. A gradual withdrawal is tolerable, but a hasty retreat could precipitate major upheavals for the U.S. economy and erode America's standard of living.

FDI's part in America's growing vulnerability is relatively minor in comparison to foreign portfolio investment. Profit and dividend remittances associated with FDI do aggravate America's balance-of-payments dilemma, but increased jobs, production, and import substitution have been significant benefits to the U.S. economy. Moreover, a good portion of FDI is not

23. HARPER'S, May 1988, at 15.

easily liquidated, meaning that many foreign investors are in the race for the long run, taking their chances on the ebbs and flows of America's future economic performance. In 1987, foreigners earned 10.5 billion dollars from their FDI in the U.S., compared with 52.3 billion dollars in earnings from U.S. FDI overseas. At the current rate, FDI in the United States is yielding 4% to 5%, in contrast to bonds which have recently yielded twice as much. Thus, FDI represents, for the moment, a relatively cheap way to finance expansion.[24]

D. *The U.S. Government Has Not Adequately Monitored FDI Activity*

Washington has both the right and the responsibility to monitor foreign investment activity in the United States. Some loopholes do exist in the current system, and with sixteen agencies collecting information, a greater effort should be made to centralize the data-gathering process. Furthermore, the Committee on Foreign Investment in the United States (CFIUS), an interagency watch-dog group established by President Gerald Ford in 1975, has functioned sporadically since its inception. CFIUS once asked French Government-controlled Elf-Aquitaine to delay its takeover of Texas Gulf, the owner of large phosphate and sulphur reserves in the United States. CFIUS wanted to gather additional information about the transaction and the potential ramifications for the U.S. resource sector in particular, and for the U.S. economy in general. Elf-Aquitaine decided it could not delay the takeover and refused the request made by this federal government group. CFIUS was widely viewed then and continues to be perceived as a toothless paper tiger.

Now that the President of the United States possesses the authority to block or delay foreign takeovers based on national security concerns, recommendations and demands made by CFIUS should carry more clout in the future. Once again, however, this presidential authority must be used sparingly and should generally be limited to cases involving (a) enterprises from hostile nations, (b) companies owned directly by foreign governments, and (c) sectors which are clearly linked to the sensitive security needs of the United States. Unfortunately, it must again be stressed that this new authority could be easily abused for parochial economic and political reasons.

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24. *Buying into America*, FORTUNE, Aug. 1, 1988, at D55.

The U.S. Government has also come a long way in expanding its monitoring of FDI activity. For example, the International Investment and Trade in Services Survey Act requires foreign investors or their affiliates to report to the Department of Commerce, within forty-five days, any direct or indirect acquisition of at least 10% of a U.S. business, including real estate, and then to submit regular quarterly and annual reports. The Department of Energy Organization Act mandates that the Energy Department must monitor FDI activity within its area of competence and forward reports to the Congress on a regular basis. The Foreign Investment in Real Property Tax Act of 1980 requires foreign investors who own real property to file an annual information statement with the Internal Revenue Service. Foreign-based corporations are also subject to the same Securities and Exchange Commission disclosure rules as U.S. corporations, and to the same antitrust provisions enforced by the Department of Justice.

Perhaps if CFIUS were to be revamped and given a permanent secretariat, all of this information concerning FDI could be funneled to its staff. More cooperation is also needed with state and local government agencies in gathering information about commercial and agricultural real estate transactions. Moreover, the ultimate beneficiary of any transaction should be identified, in a confidential manner, to U.S. monitoring bodies. Not infrequently, transactions are funneled through corporations in Delaware, the Netherlands Antilles, and Luxembourg, making it extremely difficult or impossible to ferret out the ultimate beneficiary.

At the multilateral level, the United States should also work with its OECD counterparts to iron out uniform disclosure requirements and rules concerning national treatment. But even without greater cooperation among multilateral institutions, a great deal of progress has been made within the United States in gathering relevant information about a broad range of FDI activity.

E. U.S. Subnational Governments Are Too Generous with the Incentive Packages Offered to Foreign Investors

In many respects, the assertion made in the heading is true. Because of the market advantages listed in Section III of the paper, the vast majority of FDI would enter the United States even without government incentives. Thus, as a net national expense, incentive packages are wasteful.

On the other hand, the United States has a highly competitive federal system with states, counties, and municipalities competing against one another for both foreign and domestic investment. In addition, FDI is perceived as a zero-sum game, with only one winner and the other players being losers. Many subnational governments honestly perceive that they cannot compete against their counterparts without offering incentives. Moreover, Canadian provincial governments and other foreign governments may also be players in the game, giving the competition an international flavor. For example, Hyundai located in Quebec as a result of a 110 million-dollar (Canadian) incentive package pieced together by the Canadian national government and the Quebec provincial government. With the new Canada-U.S. Free Trade Agreement, many companies can now locate in Canada and still have open access to the American market, a situation which frankly worries economic development leaders in many state capitals.

The National Governors' Association (NGA) is currently examining the pros and cons of incentive packages, and one would hope that the NGA, in cooperation with Washington, D.C., could eventually work out rules of the game which would substantially decrease the hundreds of millions of dollars in incentives being offered annually to domestic and foreign investors alike by subnational governments. But once again, the zero-sum nature of the game, and the presence at times of non-U.S. players, will make this task difficult to accomplish.

Although further research is needed, incentive packages may actually serve to steer foreign investors towards "greenfield" investments instead of acquisitions or takeovers. In 1987, FDI in the United States added up to 30.5 billion dollars, of which 25.6 billion dollars was used to acquire existing U.S. firms.[25] Greenfield investments generally create more jobs and have a more positive influence on local economies than the transfer of an existing business from one owner to another.

Hopefully, the subnational governments will also be able to work out common rules on reimbursements to be made by companies which accept incentive packages but then fail to carry out

25. Herr, *U.S. Business Enterprises Acquired or Established by Foreign Direct Investors in 1987*, SURV. OF CURRENT BUS., May 1988, at 50-52.

their commitments. For example, Pennsylvania pieced together a big incentive package for Volkswagen, but the West German firm will soon close its facility in that state, eliminating 2,500 blue and white-collar jobs with an average wage of 14 to 16 dollars per hour. The Governor of West Virginia has lodged a 615 million dollar breach-of-contract lawsuit against the Newell Company for closing its plant in Clarksburg. The former owner of the facility, Anchor Hocking, had accepted a state government incentive package of subsidized loans worth 3.5 million dollars.[26] Norwood, Ohio officials have also sued General Motors for 318 million dollars because of GM's plant closure in that city. City representatives claim that the municipality spent hundreds of thousands of dollars to improve railroad links to the GM plant, and that Norwood should be reimbursed.[27] If incentives are to be offered in the future, both subnational governments and the investors must clearly spell out what their responsibilities are, and what the penalties will be for noncompliance. Mazda has apparently understood its commitment to the community and the state when it accepted a 120 million dollar incentive package for the construction of a plant in Flat Rock, Michigan. As part of the package, Mazda received a 100% tax abatement for a dozen years. However, Mazda needed sewer and street repairs which began to strain Flat Rock's budget. This budgetary squeeze helped lead to the defeat of the incumbent mayor who had a role in negotiating the original incentive package. Mazda has now decided to donate 100,000 dollars per year to the city for the duration of the tax concessions, and has also agreed to pay one million dollars for the sewer project.[28]

On the other hand, subnational governments will have to take a closer look at their own policies which currently restrict FDI in an effort to protect locally-owned enterprises. When Beazer PLC of the United Kingdom launched its bid for Koppers, the Commonwealth of Pennsylvania suspended Shearson Lehman Hutton, which served as an equity partner in the takeover bid, from consideration for state business, including a 150 million dollar bond issue. The Wisconsin legislature also went into special session and passed a law protecting local companies against hostile takeovers by foreign holding companies. This was

26. Wall Street J., Mar. 8, 1988, at , col. 6.

27. *Id.* at 24, col. 6.

28. Borrus, Treece, Ellis-Simmons, & Ehrlich, *Japan Digs Deep to Win the Hearts and Minds of America*, BUSINESS WEEK, July 11, 1988, at 73, 74.

a last-ditch effort to thwart Australia's Alan Bond from purchasing a controlling interest in G. Heileman Brewing. The Ohio legislature quickly passed a law prohibiting the Campeau Corporation of Canada from taking over Federated Department Stores. This law was later ruled to be unconstitutional. The Kentucky legislature also tried to thwart the Belzberg family of Canada from taking over Ashland Oil. To say the least, some state governments seem to have an ambivalent attitude toward FDI activity, especially in the case of hostile takeover attempts.

V. Conclusion

In the foreseeable future, it should be expected that FDI activity in the United States will continue at very high levels as foreign investors rush to take advantage of favorable exchange rates and attractive equity and real estate prices. On the whole, this activity is healthy for the American economy and through the introduction of new technology, production, and marketing processes, should help to make the United States more competitive internationally. Subnational governments should also be expected to accelerate their own involvement in the international economy and will continue to be enthusiastic supporters of most FDI activity, a situation which contrasts rather markedly with the growing skepticism towards FDI being manifested on Capitol Hill in Washington, D.C.