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SHOULD AMERICANS BE WORRIED ABOUT FOREIGN INVESTMENT IN THE U.S.?

INTRODUCTION

American policy makers seem to be increasingly concerned about the level of foreign investment in the United States. Some policy makers fear that foreigners, by purchasing U.S. physical and financial assets, will gain influence over American foreign and domestic policy. They also believe that foreign investment somehow harms the American economy. Attention focuses especially on relatively recent Japanese direct investment. Legislation has been introduced in Congress and in several state legislatures to require foreign investors to turn over to the U.S. government detailed information concerning their business holdings and practices in America.

Are the worries of U.S. policy makers warranted? The evidence says that they are not. To the contrary, the data demonstrate that foreign investment helps the U.S. economy. Official government statistics, unadjusted for inflation, show that total foreign investment in the U.S. (passive and direct) reached $1.7 trillion last year. While this may seem like a towering figure, it is not. For one thing, it is a small share of U.S. total physical assets, estimated to be $35 trillion. For another, American overseas assets are at least $1.3 trillion. A more relevant figure may be foreign direct investment in the U.S., like ownership of factories; this is about $304 billion. Offsetting this is the $329 billion in such assets owned by Americans in other countries. In both direct investments in real estate or companies and such passive holdings as noncontrolling shares of stock in a company, foreigners own only 5 percent of all U.S. assets.

Aggressive American Investors. Even these figures do not tell the entire story. American investors continue to invest aggressively offshore. In the first quarter of 1989, U.S. companies spent $8.7 billion on foreign acquisitions.

In addition, most American investments overseas were made some time ago, according to a study just released by KPMG Peat Marwick, and are carried on the books at their historical or "book" value, unadjusted for inflation and market appreciation. U.S. overseas assets thus tend to be undervalued – in some cases, enormously so. By contrast, foreign investments in America are more recent and therefore tend to be represented in official statistics at closer to their actual market value. American direct investments overseas are more valuable than U.S. government statistics indicate.

Building Factories and Creating Jobs. Foreign direct investment in the U.S. builds factories and creates jobs, particularly in previously moribund manufacturing industries. Some three million Americans work for firms owned by foreign companies. Direct investors often bring new technology and management techniques to the U.S. market. Such investments also increase America's available capital base and boost the market value of American assets.

Foreign direct investment in the U.S. and American investments overseas are part of the ongoing worldwide economic integration. Businesses bring production closer to customers, taking advantage of such economic factors as lower wages, lower material costs, and better skilled labor and diversifying risks. The U.S. is a particularly attractive place to invest because of its political stability, lower level of taxes, and less onerous regulation of business.

Unparalleled Potential. The U.S., once again, has become a magnet for foreign investors. This should be a cause for satisfaction – even celebration – and not for worry. Said French economist Guy Laigneux in late 1987: "Even though the U.S. is now the world's most developed nation, it resembles in some important respects the developing nation it was in the last century as it shifts from the old heavy industries to the advanced technologies. Its potential for growth is unparalleled anywhere else." Adds British economist Jock Bruce-Gardyne: "Everyone wants to invest in the U.S."

To try to stop or impede this investment would damage the U.S. economy. This indeed would be the result of such U.S.-initiated measures as attempts by Congress to force foreign direct investors to reveal detailed information about their internal operations.

THE AMERICAN INVESTMENT PICTURE

Since the early part of this century, America has been a major investor overseas. Yet prior to this time, the U.S. was dependent on European investors for investment capital, and sometimes, basic liquidity. London bankers actually underwrote bonds to finance much of America's expansion westward, allowing millions of people to make this country their home.

Following the devastation of the two World Wars, U.S. companies made massive loans and direct investments in Europe and Japan. In a sense, the capital that had flowed across the oceans for decades before 1910 returned to recapitalize European society.

Benefits to U.S. While U.S. capital helped to revive industry in Europe and Japan, U.S. companies also benefited by establishing overseas manufacturing facilities, particularly in Europe, thereby avoiding the substantial tariffs imposed on "foreign" manufacturers. Today, U.S. offshore investments in European countries constitute a major advantage for the U.S. economy. Likewise, major manufacturing and retailing giants from Europe are long-established factors in the U.S. market.

There are essentially two types of investment in all market countries: passive and direct.

Passive or portfolio investment consists of noncontrolling shares of stock in companies or real estate for income purposes. Some 80 percent of the $1.7 trillion total foreign investment in the U.S. is passive. Individual investors, pension funds, and investment retirement plans all fall into this category. Direct investment consists of a controlling interest in a company or real estate.

Understating True Value. As measured by Commerce Department figures unadjusted for inflation or other distorting effects, total foreign investment in the U.S. – passive and direct – reached $1.7 trillion in 1988. The offshore assets of U.S. companies grew to at least $1.3 trillion by the end of 1988. This latter figure, however, excludes assets of U.S. financial and other institutions and thus understates the value of American overseas holdings.

The U.S. is the leading recipient of foreign capital in the form of both passive and direct investments. U.S. investors also hold more physical assets overseas than investors from any other country. All foreign investment, including passive holdings and direct acquisitions, constitutes roughly 5 percent of America's estimated $35 trillion in physical, nonfinancial assets.

According to the Commerce Department, as of the end of last year, American direct investment abroad totaled $329 billion, while foreign direct investment in the U.S. reached $304 billion. Even based on unadjusted book value, the U.S. is still the single leading foreign direct investor in the world.

The value of foreign direct investments in the U.S. 1988 ranked as follows:

COUNTRY	TOTAL	% OF ALL FOREIGN DIRECT INVESTMENT
Britain	$83 billion	27
Netherlands	$56 billion	19
Japan	$46 billion	15
Canada	$33 billion	11
West Germany	$19 billion	6
Latin America	$17 billion	6
Switzerland	$15 billion	5
Kuwait	$ 5 billion	2
Other	$49 billion	15

INVESTMENT FLOWS IN 1988

Total new foreign capital investments brought into the U.S. last year equaled $42.2 billion; total outlays by foreign investors amounted to $65 billion. The difference is accounted for in part by purchases by foreign investors using their cash deposits in American banks or receipts from sales of other assets that they hold in the U.S. New investment outlays by companies and individuals from Japan have generated particular media attention. In 1988, new capital inflows by Japanese investors of nearly $15.1 billion in new assets edged out British investors, who spent $13.3 billion acquiring new assets in America. Dutch investors ranked third with $3.8 billion in new outlays last year.

British Giant. As in 1987, foreign direct investment in manufacturing assets led all other categories, accounting for nearly half or $17.8 billion in foreign direct investments during 1988. A single transaction, British Petroleum Co. p.l.c.'s buyout of the minority shareholders of SOHIO Petroleum Company, accounted for $8 billion or nearly 45 percent of this amount. The successor company, British Petroleum America, is now America's largest domestic producer of petroleum and the largest single U.K. investment overseas.

In terms of total holdings of financial assets, 6.2 percent of U.S. corporate stock was registered to foreign owners last year, up from 4.1 percent in 1980, according to the Securities Industry Association. Total foreign ownership of U.S. corporate debt rose to 12.9 percent last year. Slightly less than 1 percent of U.S. farmland is owned by foreigners, according to the Agriculture Department. Investors from Japan own a tiny 2 percent of this total or two hundredths of 1 percent of total U.S. farmland. European and, in particular, well-established Canadian interests, such as Olympia and York, account for three-quarters of the total.

PRESENT VALUE VS. HISTORICAL COST

There is a serious problem in estimating the value of U.S. overseas assets and of certain older European holdings in the U.S. Real assets such as buildings or factories do not grow in value in official government figures with the general rate of inflation, even though their market value rises, often dramatically. As a result of accounting conventions, all figures compiled by the Commerce Department reflect book value, that is, the value of the asset at the time the investment was made. Neither the asset figures for affiliates of American manufacturing companies nor those for equity investment offshore are adjusted for inflation, let alone for market appreciation, that is, the actual amount of money that American owners would receive today for sale of these assets.

For example, $3.83 in purchasing power today is equal to $1.00 in 1950 purchasing power. As a result, figures for America's considerable, older investments abroad and, to a lesser degree, some older European and

Canadian holdings in the U.S. are significantly understated. Some analysts believe, for example, that reevaluation of the enormous real estate holdings of Canadian interests would boost the current value of that country's investment near to or above that for Japan. Most foreign direct investments in the U.S. are more recent and therefore carried on the books at more nearly their actual market value. On the other hand, since they are undervalued, older American overseas investments would sell on the free market for much more than book value. The reality, therefore, is that Americans could have more invested overseas than foreign investors have invested in the U.S.

REASONS FOR OVERSEAS INVESTMENT

There are a number of reasons why businesses might invest in countries other than the one in which they are established. There are especially good reasons why individuals and businesses from other countries invest in America.

First, an investor might gain a higher rate of return on his investment in another country. Foreigners find the U.S., with its low taxes, especially attractive compared to other countries for certain kinds of investments.

Second, increasing numbers of portfolio strategists believe that diversification among different international markets is a reliable and necessary ways to spread out business risks.

Third, direct investments in other countries can move production, marketing, and service functions closer to the customer and thereby enhance relative competitive position. Local personnel and management often can deal better with the local market conditions.

Fourth, certain businesses often can gain production advantages by locating in certain countries. They might reduce costs, for example, by locating in countries with lower labor or raw material costs or with an undervalued currency. A highly skilled work force attracts foreign-owned factories. Avoidance of government interference in business affairs is another important consideration.

Fifth, businesses and individuals typically seek to invest in politically stable countries. Nations prone to civil unrest or repression are less likely or able to respect the rights of private property. A recent survey of corporate executives by Touche Ross finds that U.S. political stability is the leading factor in attracting foreign direct investment to the U.S.

CONCERNS ABOUT FOREIGN INVESTMENTS

Since rumors of rich Arabs "buying up" ranches and office buildings in Texas began spreading in the mid-1970s, some Americans have become increasingly concerned about the possible negative effects of foreign capital on the U.S. To address this putative problem, legislation has been introduced

in Congress and in at least ten state legislatures to require additional reporting by foreign investors. Many critics of foreign investment fear that somehow, because of their citizens' holdings in America, foreign governments will gain influence over the U.S. Other critics are concerned over the economic effects of such investments. They fear that, in some unspecified manner, the presence of too many foreign-built and -owned factories in the U.S. or too many foreign-owned office buildings, condominiums, shopping centers, or tracts of farm land will lower U.S. living standards.

These concerns are unfounded for a number of reasons. Among them:

1) **Foreign investment is still tiny in terms of the entire U.S. economy.** Foreigners own 5 percent of all U.S. assets and 6.2 percent of stock. While this is of economic benefit to the U.S., it is still not so much that foreigners can "call the shots" in America. Many other countries have a much larger share of their assets owned by foreigners without loss of their sovereignty. Americans, for example, own considerable assets in Canada. And while that country and the U.S. have considerable economic and foreign policy interests in common, Canada takes an independent course in these areas whenever it thinks it necessary.

2) **The U.S. remains the largest single owner of assets overseas,** particularly manufacturing and real estate holdings in Europe. Thus, if overseas investment truly were to lead to political control, a kind of "balance of power" would exist between foreign investment in the U.S. and U.S. investment worldwide.

3) **Last year, over 85 percent of the $1.7 trillion** in foreign investment in America were passive holdings of stock and bonds, not controlling shares in businesses. Far from threatening U.S. economic freedom, these "portfolio investments" increase the U.S. capital base and provide funding for U.S. economic expansion.

4) **Critics of foreign investment ignore the fact** that there are two parties in any transaction. When one person sells to another, both benefit. Restrictions on foreign investment would be restrictions on the rights of Americans to dispose of their private property. They might not be able to sell it, for example, or perhaps could sell it only for a price far lower than if foreigners were allowed to buy it.

5) **Concern about foreign investment has focused on the Japanese,** even though they hold only 15 percent of all direct foreign investment (based on book value) in the U.S. Little concern is expressed about Britain, the largest overall investor and the eading investor in U.S. manufacturing assets, or about a "Dutch threat" from the second largest investor, the Netherlands. Nor are the Canadians, West Germans, or Swiss considered a national menace.

HELPING THE U.S. ECONOMY

Foreign direct investment in America can help the economies of both the U.S. and the foreign investor; the same is true for American investments overseas. When foreigners build plants or factories in the U.S., they create jobs for Americans. It is estimated that three million Americans work for enterprises in which foreigners hold controlling shares. This benefit of foreign investment was recognized implicitly by American organized labor and others some years ago when they complained that American businesses investing overseas were exporting American jobs. Today foreign capital is creating and preserving American jobs.

Some critics argue that rather than creating jobs, direct foreign investment often simply involves the transfer of a company and its employees from a domestic to a foreign owner. This ignores the fact that many investors build new facilities. European companies, especially the British, have established new plants in America, although in recent years they have been more involved in acquisition of going concerns.

Exporting Jobs to the U.S. Japanese auto makers such as Honda, Nissan, and Toyota have committed billions of dollars to new plants in the U.S. These new factories mean new jobs for Americans. It should be Japanese labor and critics complaining about Japanese firms exporting jobs to the U.S., not Americans complaining about Japanese investment in the U.S.

Even when a foreigner purchases an existing U.S. facility, the U.S. gains. The previous owner, usually American, receives money in return for the facility. This contributes to the American capital base, which means the capital is freed up for other investments.

Bringing New Technology. In addition, foreign purchases raise the value of U.S.-owned assets. If a foreign principal purchases a shopping center, the value of U.S.-owned office building across the street is likely to increase. Foreign investors also often bring new technologies to their enterprises located in other countries. In his November/December 1988 *New England Economic Review* article, Federal Reserve Bank of Boston economist Eric Rosengren explains:

> Foreign firms that introduce improved management, better production, or new technology produce goods and services more cheaply than would otherwise be possible. When Japan's second largest steel producer, Nippon-Kokan, purchased fifty percent of this country's fourth largest steel producer, National Steel, Nippon Kokan provided advanced technology that improved National's productivity. The substantial savings from modernization allowed National to be more competitive in international markets and reduced costs to steel purchasers.

These facilities compete with domestically owned enterprises, which in turn often adopt the new techniques themselves.

TOWARD A GLOBAL ECONOMY

Investment, direct and passive, by U.S. businesses overseas and by foreigners in the U.S. is part of the wider phenomenon of global economic integration. With better and cheaper means of international transportation of goods and with instantaneous electronic transfers of funds from one country to another, national boundaries are losing their economic importance. Businesses in different sectors invest in enterprises in different countries for as many different reasons as American businesses might have for locating facilities in various U.S. states. Countries receiving direct foreign investment gain new jobs and often new technology. The investing foreign businesses receive income, diversify business risk, and just as important, put themselves in a more competitive position worldwide.

Offshore investments by multinational companies are part of a complex web of trade and financial flows, which link the economies of the major industrial nations. U.S. firms lead in this "globalization" process with the greatest direct foreign investment of any single country, $328 billion at historical value.

Since end of World War II, the U.S. has grown immensely wealthy in part because of its overseas investments. In recent years, foreign companies, especially from Europe and more recently Asia, have made substantial commitments of resources to the American market. This is not a problem for America. It is simply part of the ongoing integration of the world economy. For example:

♦♦ Honda Motor Co., Ltd., only a minor player in the Japanese car market with less than 9 percent market share in 1988, has successfully established itself in the U.S. and now exports U.S.-built cars to Japan. Its leadership in terms of design, quality, and market penetration has forced U.S. and foreign car makers to diversify and invest to improve their own products.

♦♦ Seagrams Company, Ltd., one of the world's three leading beverage companies, owns 23 percent of America's largest chemicals manufacturer, DuPont Canada, Inc.; three-quarters of its total assets and shareholders are in the U.S.

♦♦ Nissan Motor Co., Ltd., Japan's second largest auto maker, recently announced plans to double its production of cars in its British plant to 400,000 units by the late 1990s as well as to increase production in its U.S. facilities from 260,000 to

480,000 units by 1992. Some 75 percent domestic content is targeted for vehicles from both plants.

COMPETITION REQUIRES FLEXIBILITY AND INVESTMENT

American companies, small and large, are competing with foreign firms for customers around the world. The steady integration of major product and service markets forces companies to act as dynamic players who shift sources of supply, production, and marketing from one location to another in search of the highest level of comparative advantage. A *Chicago Tribune* article this April 23 illustrates this point:

> In South Korea, a factory owned by Dae-Woo uses Japanese parts, Korean workers and German engineers to make Pontiac Le Mans cars for Americans, many of whom think they are buying an American made car.

Market Changes. The economic fortunes of companies can change quickly, requiring an open world system in which businesses can diversify production and markets across international borders. In fiscal 1985, for example, Toyota Motor Corporation generated nearly three-quarters of its income from export sales. But the following year, sales of these cars in Japan surpassed export earnings because of the rising value of the yen. Last year, nearly 73 percent of Toyota operating income came from domestic sales.

Flexibility is crucial to survival in free markets – part of the discipline of free competition. The American steel industry learned this lesson the hard way by retaining dated open hearth technology as foreign manufacturers developed new, more productive techniques in the 1970s. Efficient Japanese and German steel mills out-competed many American mills in the past two decades. In turn, the "model" mills of the 1970s, such as Nippon Steel's computer integrated Komatsu works in Kawasaki, near Tokyo, are today shut down because of aggressive competition from more efficient mills in Korea and Taiwan.

WHO IS REALLY FOREIGN?

One of the least mentioned points in the debate over foreign direct investment is just how difficult it is to discover which companies are truly foreign and which are partially – or mostly – domestic.

At present, a foreign investor or company is one with a foreign address. In the case of major multinational corporations, the foreign label says nothing about the actual nationality of the owners, the distribution of corporate revenues, or employment by such firms by country. Examples:

♦ ♦ Volvo AB SWE of Sweden is owned by over 160,000 shareholders in 50 countries, many of them American. It is involved in joint-venture truck

manufacturing operations in North America and is a major European producer of trucks and automobiles.

♦♦ General Electric Company of the U.S., which last year posted revenues over $47 billion, derives more than 40 percent of its operating profits from outside the U.S. It recently won a $750 million order to provide eight turbines for Tokyo Electric Power Company. Like those of many U.S. "blue chip" industrial firms, GE's stock and debt obligations are widely held by individuals and companies around the world.

♦♦ Mazda Motor Corporation of Japan, which is 25 percent owned by Ford Motor Company, has assisted Ford in designing the highly successful Probe model. Mazda recently agreed to a $250 million engine purchase from Ford for its new U.S. built cars. Mazda expects that Ford will supply 70 percent of Mazda's total U.S. output of 240,000 engines by 1995. All holders of Ford shares are indirect investors in Mazda, and the stock of both is widely held by institutional investors around the world.

♦♦ Citicorp, the giant New York bank holding company, has branches and subsidiaries in dozens of countries and conducts retail banking operations in West Germany, Britain, and Japan.

IS LEGISLATION NEEDED?

H.R.5, known as the Bryant Bill after its sponsor, Representative John Bryant, the Texas Democrat, would impose additional reporting and disclosure requirements on any foreign person who holds or acquires a "significant" or "controlling" interest in U.S. property or companies. New and existing investors would have to disclose specific financial data on each separate business entity controlled. This, in effect, would give competitors details of intercompany transactions, salaries, and other proprietary information. Bryant says he is concerned about the national security and asks: "How much of our petroleum industry is foreign-owned? What are the effects of such ownership on our energy dependence?"

The Bryant Bill seems unwise for a number of reasons: First, the claim that the U.S. government needs more information is spurious. The U.S. government already has sufficient general information and legal authority to safeguard the national interest. Indeed, much of the argument against foreign investment used by supporters of this bill is based on detailed information from the Commerce Department and other sources on the level of such

investments and examples of specific foreign investors owning specific enterprises in the U.S.

Inviting Retaliation. Second, the Bryant Bill would demand types of information from foreign investors that are not disclosed by public U.S. companies. Such a distinction, once made, logically would allow for discriminatory taxes and regulation. Unequal treatment violates basic international investment agreements and almost certainly would invite retaliation against large overseas U.S. investors.

Third, the new registration law would discourage investments in the U.S. Bryant denies this, but then admits that he would use the information gathered to "guide foreign investment where it is needed and keep it out where it is not needed." Since many supporters of H.R.5 seem to believe foreign investment is bad for the U.S. and see this bill as a way to control such investment, it is likely that they will seek to limit certain kinds of investment. More detailed data are needed only if there is to be direct government regulation of foreign direct investment.

Any action taken by host countries to raise the cost of investments or lessen investor confidence will discourage investment. Ford, for example, changed the site of a future facility from Scotland to Spain because of labor difficulties. If the U.S. or another country restricts foreign direct investment, investors may be persuaded to build plants some place else.

CONCLUSION

The benefits of foreign investment flows—jobs, economic growth—are apparent in American life. Less apparent, however, is the enormous stake American companies and individuals have offshore in other markets. Because of the leading direct international investment position of the U.S., self-interest, at least, demands that American leaders encourage free trade and free markets.

Improving Competitiveness. A commitment to free trade and capital flows not only protects immediate U.S. interests, but ensures that American industry will continue to improve its competitive position vis-a-vis other players in Europe and Asia. Industries such as steel and textiles might be protected in the short run by import quotas, but such legal devices ultimately would sap the incentive for innovation and improved productivity.

Even without the enactment of legislation, the environment toward foreign investment in the U.S. has grown more hostile. Rather than risk government intervention after the fact, foreign investors increasingly are making application to the interagency Committee for Foreign Investment in the United States (CFIUS) in essence to apply for prior government approval. At least ten states have placed reporting requirements or legal restrictions on the business activities of nonresident investors. These developments represent a dangerous trend.

Lesson of History. Those who believe that the U.S. is a "developed" country, which no longer benefits from or needs foreign ideas, people, and capital, are dead wrong. The history of failure in closed economies such as the Soviet Union, China, Poland, and Mexico illustrates the dangerous decay brought about by economic isolation.

Attempts to limit the free flow of capital across national borders must be seen in the same context as such protectionist policy remedies as industrial policy, managed trade, and general government intervention in the domestic marketplace. Business and political leaders with an interest in a future strong and competitive American economy must oppose calls for limits on foreign investment.

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