The original documents are located in Box B48, folder "Foreign Investment in the U.S. (2)" of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

NATIONAL ARCHIVES AND RECORDS SERVICE

WITHDRAWAL SHEET (PRESIDENTIAL LIBRARIES)

FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
	1. memo case, Bennett to Burns, 2/19/75		
~~1a. memo~~	~~Foreign Investment in the United States - Summary of Issues and Background (7 pp.)~~ opened 9/10/09	~~[2/75]~~	~~A~~
~~1b. memo~~	~~Options for U.S. Policy on Foreign Investment in the United States (24 pp.)~~ opened 9/10/09	~~2/18/75~~	~~A~~
~~1c. memo~~	~~re Probable Foreign Reaction to U.S. Actions (5 pp.)~~ opened 9/10/09	~~2/18/75~~	~~A~~
1d. report	re OPEC Finances (12 pp.)	1/29/75	A
~~1e. minutes~~	~~extract from minutes of CIEP Executive Committee Meeting (1 p.)~~ opened 9/10/09	~~12/21/73~~	~~A~~
~~1f. minutes~~	~~extract from minutes of CIEP Executive Committee Meeting (1 p.)~~ opened 9/10/09	~~5/22/74~~	~~A~~
~~1g. memo~~	~~U.S. Policy and Objectives on International Investment (9 pp.)~~ opened 9/10/09	~~[5/74]~~	~~A~~

FILE LOCATION

Arthur Burns Papers
Federal Reserve Board Subject File, Box B48
Foreign Investment in the U.S. (2)

SR
4/20/84

RESTRICTION CODES

(A) Closed by Executive Order 12065 governing access to national security information.
(B) Closed by statute or by the agency which originated the document.
(C) Closed in accordance with restrictions contained in the donor's deed of gift.

THE UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS
WASHINGTON, D.C. 20220

February 19, 1975

MEMORANDUM FOR THE HONORABLE ARTHUR F. BURNS
CHAIRMAN, BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM

Attached are two sets of the option and background papers for the meeting next Monday on U. S. policy on Foreign Investment in the United States.

The meeting, which is scheduled for February 24, at 10:30 a.m., will be held in the Roosevelt Room at the White House.

Jack F. Bennett

Jack F. Bennett

Attachments

THE UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS
WASHINGTON, D.C. 20220

February 14, 1975

MEMORANDUM FOR THE HONORABLE ARTHUR F. BURNS
CHAIRMAN, BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM

Secretary Simon and General Scowcroft have asked that I attempt to arrange a meeting at which options and a possible recommendation for the President may be considered for future U.S. policy on foreign investment in the United States. This meeting has been scheduled for 10:30 AM Monday, February 24, and will probably last from an hour to an hour and a half. It has been suggested that each department limit its attendance to a principal plus one. I know that Secretary Simon and General Scowcroft would be grateful if you could personally attend.

An interagency committee has prepared a set of options and background papers for your consideration and these will be circulated promptly.

The place of the meeting will be announced later. In due course, I would be grateful if your office could inform my office on 964 - 5847 of those who are expected to attend.

Jack F Bennett

Jack F. Bennett

AFB -
Gov W -
Fed - Bd

Foreign Investment in the United States: Policy Review

Contents

Foreign Investment in the United States: Policy Review

Contents

Foreign Investment in the United States
Summary of Issues and Background

The Problem

The United States has traditionally followed a policy of freely admitting foreign investment to the United States, offering no special incentives and, with a minimum of government intervention to protect national security and other essential interests, imposing no special barriers to foreign investors. This policy has been based on the belief that U.S. interests are best served by permitting the free flow of capital across borders in response to market forces.

The recent large accumulations of funds by oil-producing countries, coupled with the fact that these accumulations are mainly in official rather than private hands, adds a new element to international investment. For example, investments by foreign governments raise the issue of political motivation. Moreover, an array of investments made by a government are subject to coordinated control to a degree that does not arise in the case of similar investments made by unrelated private investors within a particular country. Concern has been expressed in the Congress and by the U.S. public over the adequacy of our controls on foreign investment to protect against abuses by foreign investors.

In light of these developments, should the U.S. Government modify its existing policy (1) toward inward foreign investment or (2) toward inward investment by official foreign investors?

Key Issues

1. Is it likely that the funds that OPEC will have in the United States will be of sufficient magnitude to create the risk that OPEC investors might have a pervasive effect on our foreign or domestic policies or our attitudes?

2. Irrespective of the potential magnitude, are existing safeguards adequate to protect against undesirable behavior by foreign investors or undesirable foreign investment, for example concentrated in particular industries, especially in areas of national security or essential national interest?

3. Should official foreign investment, particularly from OPEC countries, give rise to more concern than private foreign incestment?

4. As there are proposals before the Congress to restrict inward foreign investment, should the Executive Branch make a preemptive move in order to head off unduly restrictive legislation?

5. What are the chances that the Congress would amend any Administration requests for legislation on foreign investment in a manner that would be unacceptable to the Administration?

6. Would it be preferable to delay any decisions until we have a better feel for the magnitude and timing of OPEC investment in this country and Congressional and public reaction to it?

7. Is a prompt decision desirable to reduce uncertainty here and abroad regarding U.S. policy on foreign investment in this country?

8. Would new U.S. restrictions on inward foreign investment result in (a) further restrictions by foreign governments on U.S. investment overseas, and/or (b) restrictions by other countries on OPEC long-term investments that would have the effect of keeping OPEC funds in short-term instruments, thereby adding to the uncertainties of the international financial system, and/or (c) a reduction in oil production?

9. Is there a risk that a change in U.S. policy on inward foreign investment might deter desirable investment or cause foreigners to sell off their holdings of U.S. securities?

10. To what extent would a more restrictive policy be inconsistent with FCN treaty obligations and other international agreements?

<u>Basic Options</u>

After an extensive review of current U.S. laws and regulations relating to business activities and foreign investment in the U.S. economy, and bearing in mind the economic and political implications of the OPEC surpluses, the following four options have been developed to facilitiate consideration of future U.S. policy with respect to such investment:

1. Maintain existing policy and improve implementation by executive action, including the handling of problems of foreign government investment on a bilateral government-to-government basis.

2. Seek new legislation to improve reporting requirements and strengthen existing powers to prevent abuses.

3. Seek legislation to require screening of

   (a) all foreign investment in key industries, or

   (b) all official foreign investment, or

   (c) all official foreign investment in key industries.

4. Seek legislation to establish percentage ceilings on official foreign investment, possibly combined with legislative authorization for special investment funds for foreign governments.

More detailed discussion of the options is at Tab A.

Background

U.S. policy has been based on the belief that foreign investment in the United States contributes to the dynamism of the American economy by stimulating competition, and government intervention has been kept to the minimum necessary to protect national security and other essential interests. Attached at Tab F are papers approved by the CIEP Executive Committee in December 1973 and May 1974, which give a further statement of this policy and put it in the context of international investment reform. These papers, however, did not take account of the full implications of the financial accumulations of the OPEC countries.

At the end of 1973, the book value of foreign direct investment in the United States was $17.7 billion and the market value of foreign portfolio investment in U.S. corporate securities was $36.8 billion. (The comparable figures for U.S. investment abroad are $107 billion and $25.2 billion respectively.) Although full data for 1974 are not yet available, it appears that OPEC direct and private portfolio investment in the United States was less than $1 billion. Nevertheless, the potential that the OPEC countries have for foreign investment makes it essential that the United States have the means to obtain adequate, timely information on foreign investment in this country and adequate means to protect itself against investment which is inimical to our national interest.

Present reporting requirements of various Federal agencies produce substantial information on foreign investment in this country. The major information collectors are the Commerce Department (on direct investment), the Treasury Department (on portfolio investment) and the Securities and Exchange Commission (on acquisitions of more than 5 percent of the stock of a company whose securities are publicly traded). Other regulatory agencies and the Department of Defense also collect information on foreign investment in U.S. companies subject to regulation by them. Moreover, the benchmark surveys being undertaken by the Commerce and Treasury Departments will yield summary results by October 1975 and comprehensive data by April 1976 on inward long-term foreign investment as of the end of 1974.

The important gaps in information available to policy makers result from their inability to obtain data on specific transactions. Although the Commerce Department obtains data on direct investment in this country, it is constrained by current laws and procedures from disclosing this information to other Federal Government agencies. Also, the SEC obtains information only on transactions in the shares of publicly traded and registered corporations. Difficulty in tracing beneficial owners may be an important information gap. The SEC is presently inquiring into this issue, among others, and may recommend changes in legislation or practice.

The bills introduced in the 93rd Congress give an indication of what might be expected in the current Congress. They fell in four broad categories: Proposals to (1) establish percentage limitations on foreign ownership of any U.S. enterprise or U.S. firm in certain industries, or debt participation, (2) establish an agency to collect information on foreign participation in the ownership of U.S. firms and require U.S. firms to report foreign ownership, (3) require advance notice of purchase of an interest in a publicly held U.S. firm and permit the Government to act in advance to block undesirable acquisitions, and (4) restrain foreign firms from doing business in the United States.

Proposed legislation in some of these categories has already been introduced in the 94th Congress. Senator Williams has sponsored legislation that would <u>inter alia</u> require (1) disclosure of beneficial ownership, (2) issuers of registered securities to file with the SEC the names and nationalities of all foreign owners of their equity securities and (3) foreign investors to file 30 days in advance confidential statements on tender offers to acquire five percent or more of the equity securities of a U.S. company. The Williams bill would also permit the President to review and prohibit tender offers during the 30-day period, and the SEC, the Attorney General, or any U.S. corporation in which a foreigner had acquired an interest, or any shareholder of such corporation, would be authorized to sue in a U.S. court to unwind a transaction. Senator Hugh Scott has introduced a bill that would require any foreign investor or his agent to submit quarterly reports to the Commerce Department on investments of 0.5 percent in any U.S. firm worth more than $10,000. Representatives Fish and Roe have introduced identical bills to establish a Joint Congressional Committee on foreign investment in this country and a National Foreign Investment Control Commission which would control foreign investment and, possibly, be given authority to require divestiture. Representative Stark has proposed legislation to prevent foreigners from owning more than one U.S. bank.

To forestall the possibility of foreign investment that might be harmful to national security or other essential interests, a number of Federal laws, regulations, and administrative practices currently ban or severely limit foreign investment in certain industries, such as atomic energy, aviation, shipping, and communications. Defense Department regulations act as an inhibition on foreign acquisition of any firm that does classified work for the Government in that such acquisition could cause the firm to lose defense contracts. Moreover, a number of Federal and state laws and regulations assure that economic activities of companies, irrespective of ownership, are consistent with national and/or community interests. Some of the more important of these are antitrust laws, export controls, SEC laws, the National Labor Relations Act and state laws giving certain protections to minority shareholders against majority shareholders. In addition, the Federal Government has broad powers--in the Defense Production Act, the Selective Service Act, and the Trading With the Enemy Act, the latter of which is only available in a national emergency declared by the President--to control and regulate the activities of companies in the interest of national security and to deny access to defense secrets by any firm under foreign ownership, control or influence.

Thus it may be argued that a variety of laws, regulations, and administrative practices generally protect against the possibility of foreign investors abusing their position in this country. However, it may be asked whether existing laws are adequate to deal with politically motivated investments or with the political influence that foreign governments might gain from the holding of controlling interest in a number of important U.S. firms. The issue is posed by the fact that most OPEC investment is official rather than private.

The paper at Tab B is a more detailed discussion of the disclosure requirements on foreign investment in this country and the safeguards against unwanted foreign investment.

At the macroeconomic level, the basic case for freedom of capital flows into the United States is the same as the basic case for a free enterprise economy. The general presumption is that market behavior motivated by self-interest will lead to socially desirable outcomes and a more efficient allocation of resources. For the period immediately ahead, oil-producer investment funds can be an important new source of funds to finance the capital requirements in the private sector and presumably will result in an increase in capital formation over what otherwise would occur. The outflow of dividend and interest payments to foreign investors is matched by an equivalent or greater increase in national income as a result of the foreign capital. Moreover, the increased competition can lead to innovation by foreign firms, lower consumer prices, and increases in the quality of products. This effect can occur both from takeovers and acquisitions as well as new investment. The paper at Tab C is a more detailed discussion of these points.

There also exists the possibility of official investments being coordinated from abroad to hinder competition. Also, the more important foreign official capital becomes in the U.S. private sector, the more this sector is subject to potential control by foreign governments whose interests do not necessarily coincide with those of the United States.

Foreign reaction to any change in U.S. policy on inward foreign investment will depend upon the severity of the change and the nature of the country. A mandatory registration procedure and disclosure would probably bring no reaction from other OECD countries or less-developed countries. If OPEC countries thought that registration and disclosure represented a fundamental shift in the U.S. investment climate, they might be concerned; however, they would also recognize that, even with these requirements, the United States would still be one of the least restrictive places for OPEC investment. Screening or added restrictions could produce a more negative reaction, and inhibit OPEC countries from making some investments, but this possibility would be reduced if the restrictions were limited to a few sectors.

New U.S. restrictions, particularly if they exceeded the restrictions of other OECD countries or violated FCN treaty obligations, could become an issue with other OECD countries, have a negative effect on our efforts in the OECD to maintain liberal policies toward foreign investment, and in general encourage other countries to adopt restrictive investment policies. The treaty problem, in particular, will have to be given careful consideration. (An explanation of our FCN treaties is given in the second appendix at Tab A.

As non-OPEC, less-developed countries have insignificant investment in this country and already follow fairly restrictive policies toward foreign investment, moderate new U.S. restrictions probably would not result in retaliation against our investments, but they might diminish the credibility of our support of freedom of capital flows and make more difficult our efforts in the United Nations and other international organizations, and in bilateral negotiations, to limit the spread of economic nationalism. (The possible foreign reaction is discussed in greater detail in the paper at Tab D.)

Estimates of the magnitude of funds which will be available to OPEC countries for investment in this country and elsewhere vary widely depending on the assumptions one makes regarding a number of uncertain variables such as: (1) inflation, (2) the absorptive capacity of oil-producing countries (3) the price of oil, (4) the return on OPEC investments and (5) the distribution among OPEC countries of any production cutbacks undertaken to maintain oil prices. Most recent projections suggest OPEC accumulations are likely to be in the range of $200-300 billion in 1980, and the 1985 total may be somewhat less than in 1980.

Current estimates are generally below those being made 6-8 months ago. However, while the exact amount is uncertain, OPEC investable surpluses will clearly be very large.

If OPEC financial accumulations were assumed to be $250 billion in 1980, they would be on the order of seven percent of the total value of the OECD and other major international financial markets. If OPEC countries invested 20 percent of their total financial accumulations in the United States, this would amount to 1.5-2.0 percent of all U.S. financial assets. It should be noted that even with funds equal to one percent or less of the value of our financial markets, oil producers could buy controlling interests in many firms that might be considered sensitive.

The first attachment at Tab E is a paper which compares the various current estimates on OPEC financial accumulations by 1980, and the second paper at this Tab is a discussion of OPEC accumulations as a proportion of financial markets in 1980.

A

~~[illegible]~~

February 18, 1975

Options for U.S. Policy
On Foreign Investment in the United States

After an extensive review of U.S. laws and regulations relating to business activities and foreign investment, and bearing in mind the econmic and political implications of large OPEC surpluses, four options, which are discussed below, have been developed to facilitate consideration of future U.S. policy with respect to such investment. The proposed options distinguish between official and private foreign investment and between choices that may be adopted by the Executive Branch or require legislation. The first three options are presented in an order representing increasing U.S. Government intervention. The fourth option represents a more specific limitation, but it applies to official foreign investment only.

~~[illegible]~~

Option 1 - Maintain existing policy and improve implementation by executive action, including the handling of problems of foreign government investment on a bilateral government-to-government basis.

This option would maintain our traditional open door policy and rely on existing restrictions and controls to regulate foreign investment in the United States. It would, however, improve implementation of our current policy by (1) making administrative changes to expand our existing data gathering and dissemination capability; (2) enforcing more rigorously existing laws and regulations to control the entry and activities of foreign investors; and (3) creating a new office within the Executive Branch to serve as a focal point for government activity with respect to foreign investment in the United States.

Within current authority the Administration could also deal with official foreign investment on a bilateral government-to-government basis, making use of the Joint Commissions whenever possible. The details could vary depending on the country, but the essence would be for the investing government to define its investment goals and for us to note areas where investment is legally permitted and indicate kinds of activity that would cause us problems. The arrangement might take the form of an agreement between the U.S. Government and the investing government.

Advantages

-- Utilizes powers the Administration has under existing laws and does not require action by Congress, which might overreact and add unnecessary restrictions on foreign investment.

-- Requires substantial current information (including identity of beneficial owner) on all significant foreign investment in publicly-traded companies U.S. companies with more than $1 million assets and more than 500 shareholders.

-- Can be put into effect immediately whenever the President decides action is necessary.

-- Adoption would give the Administration further time to evaluate the need for more drastic action.

-- Consistent with our desire to create a free and open economy and avoids new restrictions which could invite retaliation, violate FCN treaties and undercut our efforts in the OECD to encourage more liberal investment policies.

-- Treats substantial foreign government investment as a political/foreign policy matter particularly suitable for government-to government negotiations.

-- Enables USG to give informal guidance, which is a type of screening of foreign investment.

-- Minimizes the likelihood of possibly contentious investment.

-- Provides umbrella for foreign government investment in the U.S.

-- Provides advance notice of foreign investment and time by using existing legal and foreign policy tools.

<u>Disadvantages</u>

-- Existing confidentiality requirements would limit disclosure of information on individual investors in areas not covered by SEC.

-- Congress may not be satisfied with a system which only requires disclosure of the beneficial owners of publicly traded companies.

-- May not preclude Congressional action to enact new restrictions and/or reporting requirements.

-- Bilateral arrangements between the U.S. and investing governments may foster bilateralism.

-- Bilateral arrangements would involve the U.S. Government in the investment process which might make us subject to charges of arbitrarily favoring certain types of investments.

-- Consultation between the U.S. and the investing governments may not adequately protect against unwanted foreign investment.

-- Existing laws and residual powers to control foreign investment may not be adequate to deal with foreign government investment which may be motivated by political objectives.

Discussion

Adoption of this option is based on the assumption that our existing powers and recourse to bilateral consultations are adequate for the present to provide sufficient information on, and control of, foreign investment in the United States.

The administrative changes in existing programs might include action by the SEC to (1) require specific identification on its report forms of the nationality of all foreign beneficial owners; (2) compile and publish a list of foreign beneficial owners; and (3) express its intention to impose all available sanctions (including the loss of voting rights) on persons who violate its regulations. Commerce Department (BEA) regulations require reports to be filed with respect to every business enterprise in the United States when foreign participation exceeds $2 million and foreigners own an interest that exceeds 10 percent in such enterprise. However, confidentiality requirements prevent disclosure of any information re individual investors. Administrative changes could be made to lower the percentage holding to 5 percent and the $2 million exemption to a smaller figure.

Our general laws to ensure against abuse of economic power and a series of laws dealing specifically with foreign investment give us substantial existing power to prevent foreign investors from acting contrary to our national interest. This option would see that these laws were rigorously enforced by centralizing watchdog responsibility with respect to violations of existing laws in a newly created office which would report periodically on the adequacy of existing protections and controls.

Other functions of the new office would be to obtain (to the extent permitted by existing confidentiality requirements) data on foreign investment from all departments and agencies actually collecting data; to explore the extent to which these confidentiality requirements could be relaxed; and to prepare and publish periodic reports on foreign investment. The new office could be created by Executive Order, accompanied by a statement from the President or high Administration official outlining in detail the extent of our existing authority and information.

By centralizing information and publishing periodic reports on foreign investment, we could provide adequate information on significant non-government investment even though there might be minor gaps as noted above. In addition, existing laws give us broad power to prevent misuse of foreign investment motivated by purely economic considerations. Whether this is also adequate to handle OPEC government investment depends on an assessment of the amount, timing and direction of such investment flows and on whether OPEC governments will be governed by political or economic motives. The provision in this option for government-to-government consultations (that is, in addition to the consultations already being carried on) recognizes that different OPEC investors will have different investment objectives and needs and provides a flexible means of tailoring our policy response to those needs.

Option 2 - Seek new legislation to improve reporting requirements and strengthen existing powers to prevent abuses.

Definition of Option. Under this option, the Administration would ask Congress for legislative authority to remedy the weaknesses in our existing reporting and disclosure requirements for foreign investors. These improvements could be effected by building on an existing set of requirements, for example those administered by the SEC, or by establishing a new reporting system and a bureaucracy to administer it. They would be designed to enable us to obtain more complete information as to the identity of foreign investors in firms whose stock is publicly traded, as well as additional information on transactions involving real estate and non-public companies.

The Administration might also seek legislation to improve our existing powers to prevent foreign private and/or government investors operating in our economy from acting in a way contrary to our national interest. It would not touch on entry of foreign investment -- which would continue to be governed by existing laws -- but would concentrate on use of the investment once the foreign investor was established here. The improvement in our powers to control, and to remedy abuses caused by, existing investment could be provided by (1) plugging gaps in and/or expanding the President's existing emergency powers -- under the Defense Production, the Selective Service, and the Trading with the Enemy Acts -- and/or (2) plugging gaps in existing general laws affecting foreign investment.

Advantages

-- Meets Congressional concerns about the adequacy of our information gathering capabilities.

-- Adoption would give the Administration further time and better information to evaluate the need for more drastic action.

-- Allows a free flow of investment into the U.S. but improves our existing power to prevent action contrary to our national interest.

-- Utilizes powers the U.S. has under existing laws to regulate entry of foreign investment.

-- Concentrates the remedy on the problem of possible misuse of foreign investment.

-- Consistent with our desire to create a free and open economy and avoids new restrictions which could invite retaliation, violate our FCN treaties, and undercut our efforts in the OECD to encourage other countries to adopt more liberal investment policies.

-- Would expand existing authority to deal with extreme abuses after the fact.

Disadvantages

-- Does not meet concerns about deficiencies in existing powers to deal with misuse of assets by a foreign investor and does not provide protection against "pervasive foreign influence."

-- Requires Congressional action and may serve as magnet for more restrictive legislation and/or focus unwanted Congressional attention on the President's emergency powers -- which are already under attack in Congress.

-- Creating a general reserve or residual power in the President would, without precise standards or guidelines for its use, create great uncertainty for a foreign investor and might discourage foreign investment in the U.S.

-- Any expanded (or new) powers would be primarily remedial and would not prevent all abuses of foreign investment in the U.S.

-- There are substantial doubts (which need to be resolved) as to whether the President could be given such general powers to undo, resolve, or mitigate an individual investment (as opposed to a class or category of transactions) once it had been established here.

This option is concerned with improvements in our data-gathering and disclosure capabilities, as well as our capability to deal with abuses by foreign investors, including our powers to correct extreme abuses after they occur. The changes would be achieved by legislative action. Adoption of the option would still allow investment to flow freely into the United States in accordance with existing laws, on the assumption that there is no clear way in all instances of identifying unwanted foreign investment until the activities of the investor are evaluated. (A number of U.S. laws already prevent or limit foreign investment in various industries.)

The legislative changes would be designed to remedy the weaknesses in our existing reporting and disclosure requirements with respect to foreign investment that could not be adequately dealt with by administrative action. A major weakness of our existing requirements relates to the identification of "beneficial owners" or the equity of U.S. firms. This problem could be easily solved if all that was involved in this type of case was use of a domestic nominee by a foreign investor. In fact the SEC has recently held hearings on this issue and may soon be proposing changes in its practice or legislative authority to enable it to deal with the nominee question. However, a simple disclosure requirement would not be sufficient in a case where a foreign investor used a foreign nominee (or series of them) to conceal his identity. Penetration of these nominee "veils" would in many instances prove impossible because of problems of legal jurisdiction and of protections embodied in the commercial and bank secrecy laws of other countries. It should, however, be noted that a foreign investor hiding behind nominee "veils" who voted his shares or otherwise acted in a way contrary to the interest of the firm or the United States would probably expose himself by his action.

A possible solution to the nominee problem would be to ask Congress to authorize a strong disclosure requirement backed up by an effective penalty for non-compliance. One such penalty that has been suggested is suspension of the voting rights of the stock in question, but other possible formulas might be identified and explored. Responsibility for implementation of the new requirements could be given either to an existing agency or to one created especially for this purpose.

With regard to improving our powers to prevent or to correct major abuses, we would concentrate on weaknesses in the Defense Production Act, the Selective Service Act, and the Trading With the Enemy Act.

The Department of Defense has reservation as to the extent of the President's powers under the Defense Production and the Selective Service Acts to ensure the availability of productive capacity for Defense purposes. For example, there are doubts as to (1) the extent of the President's powers under these acts to prevent plant closure or to require continuation of defense related business, and (2) application of the Selective Service Act in a non-war situation. In addition, the Trading With the Enemy Act is under increasing criticism in Congress, and new legislation might be necessary to ensure its continued application in a non-emergency situation. Moreover, there are doubts as to whether the President could (or would want to) apply the Trading With the Enemy Act after the fact to undo, or mitigate abuses by indivual foreign investors on an ad hoc case-by-case basis without precise standards. Therefore, any consideration of broad new emergency powers to deal with foreign investment after it had entered would need a careful review of the legality and desirability of giving the President broad powers to control (e.g. seize or divest) individual firms on an ad hoc basis.

Adoption of the option would not give absolute assurance that it would prevent all possible abuses by foreign investors. On the other hand, there are numerous and possibly more effective measures outside the field of investment (for example, selective letting of contracts or placing of purchase orders, or selective placement of funds) that a foreigner could employ to influence a U.S. firm to act in a desired way.

Option 3 - Impose Screening Procedures on Inward Foreign Investment Under New Legislation

Definition of Option - This option calls for the establishment of a mandatory screening procedure, to be applicable to new direct investment as well as foreign acquisitions and mergers with U.S. firms. Its application to certain investments would be prohibited by existing FCN treaties. It would be supplemental to our existing measures affecting foreign investment.

The screening procedure could be established in either of three ways. Suboption A is a discussion of a screening procedure applicable to all foreign investors in industries that are considered "key" to the U.S. national interest. Suboption B is discussion of a screening procedure applicable to official foreign investment in all sectors of the U.S. economy. Suboption C is a discussion of a screening procedure applicable only to official foreign investment in key industries.

The suboptions have several elements in common. The criteria for the screening process should be published to avoid confusion on the part of foreign investors and U.S. firms. Each suboption would require prior notification of a central authority which would be responsible for ascertaining, in accordance with internal U.S. Government procedures to be developed, whether there was any objection to the transaction.

If this option should be adopted, it would be desirable to invoke currently available authority to prevent foreign investors from rushing into the U.S. market ahead of the enactment of legislation. Such authority is found in Section 5(b) of the Trading With the Enemy Act as amended; a legal statement on the Act is the second appendix to this paper.

Screening of certain investments would conflict with some Treaties of Friendship, Commerce and Navigation. Accordingly, further study would be necessary to determine how potential treaty conflicts might best be handled, for example, by prior consultation aimed at avoiding a treaty conflict, by renegotiation of relevant treaties, or by having the screening legislation exempt treaty countries from the screening process. The first Appendix to this paper contains a discussion of the FCN Treaty issue. It should be noted that the problem of a treaty conflict arises, in the case of screening initial investments, only with a few countries (many of which are OECD members and non-OPEC members) from which official foreign investment is limited. Moreover, all FCN treaties permit screening of investments in certain sensitive areas.

Suboption A - Screen foreign investment in industries that are key to the national interest.

Definition of Suboption A. This proposal requires a prior determination that certain industries are key to the national interest and that all foreign investment in these industries should be screened, before the investment is consummated.

Advantages

-- Deals directly with the concern that foreign investors might gain an unacceptable degree of influence in key industries.

-- Provides an opportunity for the U.S. Government to prohibit any foreign investment in key industries or to allow it to proceed subject to whatever conditions the Government might decide to apply.

-- Might remove some uncertainty regarding U.S. policy on foreign investment.

-- Reduces possibility that Congress might impose unacceptable restrictions.

-- Nondiscriminatory between investors.

Disadvantages

-- Definition of key industries is inherently difficult or arbitrary.

-- Administration would be continuously subjected to pressure from foreign investors, U.S. firms, or interested third parties to make decisions on grounds not related to national interest.

-- Congress may pass more restrictive legislation anyway; particularly Congress may add to the list of proscribed sectors.

-- Complex, cumbersome and expensive to administer.

-- Places affected firms at a disadvantage in raising capital.

-- Risk that U.S. Government might block or restrict transaction would prejudice seller's bargaining position.

-- Marked departure from our longstanding commitment to creation of a free and open world economy and our efforts to achieve international investment reform.

-- Screening could deter some desirable foreign investment.

-- May be in conflict with FCN treaty obligations.

Discussion

A significant difficulty with Suboption A is the problem of defining an industry or company that is key to our national interest. Any definition is subject to criticism. For example, any company that requires a security clearance to work on a U.S. Government contract could be considered key; this definition would, however, apply to some 12,000 U.S. firms. One might also screen foreign investment in U.S. firms that do not use advanced technology and do not produce defense-related goods but are critical to national survival. Examples include (by no means exhaustively) the steel industry, food and foodstuff processing, and vehicles and parts. Factors that would have to be taken into account in developing a screening procedure for foreign investment in key industries are given in the annex to this option. Any lists of key industries would generate pressure for additions which would be reflected in the Congress.

Suboption B - Screen official foreign investments in U.S. industries.

Definition of Suboption B. This proposal focuses on the type of foreign investor rather than on the U.S. concern and applies a screening procedure to official foreign investment. Private foreign investment would continue freely to enter the United States subject to the prohibitions and restrictions of current U.S. laws and regulations.

Advantages

-- Deals directly with the concern that foreign governments might make unwanted investments in U.S. firms.

-- Provides an opportunity for the U.S. Government to prohibit any official foreign investment or to allow it to proceed subject to whatever conditions this Government might decide to apply.

-- Removes uncertainty regarding U.S. policy on private foreign investment.

-- Avoids need to specify in advance industries in which foreigners may not invest.

-- Reduces possibility of Congressional action and risk that unacceptable restrictions might be imposed.

Disadvantages

-- Creates uncertainty for official foreign investors.

-- Might discourage official foreign investment

-- Would be regarded by OPEC countries as specifically directed against them.

-- Might lead to charges of discrimination between various official foreign investors. including charges of FCN treaty violations.

-- Difficult to define an official foreign investor.

-- Administration would be continuously subject to pressure from official foreign investors, U.S. firms, and interested third parties.

-- Complex, cumbersome, and expensive to administer

-- Risk that U.S. Government would block or restrict transaction would prejudice seller's bargaining position.

Discussion

A critical element in Suboption B is the definition of official foreign investment. A test of the functions of the investor may be inadequate, as in many foreign countries enterprises that would be regarded in the United States as in the private sector are government corporations or government-controlled corporations. Moreover, some monarchies have immense wealth for foreign investment and follow motivations sufficiently different from a private investor so as to be regarded as official investors; this is particularly true with respect to OPEC countries in the Middle East.

The term "government corporation" or "government-controlled corporation" covers several obvious categories of organizations and enterprises (central government departments, central monetary authorities and central banks). Government-controlled corporations that engage in commercial activities (for example, foreign airlines and some industry) present a special problem of definition. Also, a gray area arises in the case of government-private joint ventures, with either private foreign or U.S. citizens. Moreover, while it might be obvious that the screening procedure should be applied to investment by monarchs, it is less clear to what degree of kinship the procedure should be applied. In light of the extended family relationships in some countries, it might be necessary to look to laws and traditions of the country from whence the foreign investor comes.

Identifying official foreign investors could be made difficult by the use of intermediaries in the United States or abroad.

<u>Suboption C</u> - Screen official foreign investment in key U.S. industries.

<u>Definition of Suboption C.</u> This suboption gets down to the central issue of insulating key U.S. industries from manipulation by those foreign investors who might be most likely to be motivated by political rather than economic considerations. It would not apply to all private foreign investment or to official foreign investment in nonessential industries,

<u>Advantages</u>

-- Deals directly with the concern over the potential for unacceptable control by official foreign investors over key U.S. industries.

-- Introduces no new restrictions on private foreign investment.

-- Does not overtly discriminate against OPEC countries.

-- Might remove some uncertainty regarding U.S. policy or foreign investment.

-- Nondiscriminatory between foreign countries.

Disadvantages

-- If applied to all countries, apparently conflicts with a number of FCN treaties (i.e., provision on national treatment for establishment and acquisition). If applied only in absence of such FCN treaty provisions, then issue of OPEC unhappiness over policy aimed almost entirely at them is intensified. (We have no such FCN treaty provision with any OPEC country.)

-- Will be viewed by OPEC countries as aimed specifically at them in attempt to control their investment options, which could lead to some reductions in oil production.

-- Does not cover land sales, _per se_, which, while difficult to deal with in view of predominate role of State and local governments in land use questions, is a politically sensitive issue.

-- Definition of key industries is inherently difficult or arbitrary.

-- Administration would be continuously subjected to pressure from foreign investors, U.S. firms, or interested third parties to make decisions on grounds not related to national interest.

-- Congress may pass more restrictive legislation anyway; particularly Congress may add to the list of proscribed sectors.

-- Complex, cumbersome and expensive to administer.

-- Places affected firms at a disadvantage in raising capital.

-- Risk that U.S. Government might block or restrict transaction would prejudice seller's bargaining position.

-- Screening could deter some desirable foreign investment.

ANNEX to OPTION 3

Screening of Foreign Investment in Key Industries

I. Introduction

The purpose of this annex is to illustrate how a screening procedure might be structured and to present an example of a possible set of screening criteria. There are numerous possible variations of any such procedure and the following factors are for the most part the minimum measures which would have to be adopted. If the Administration were to choose the screening option, then considerable further effort in developing the procedures and criteria would be necessary.

II. Scope

Screening would supplement current laws, regulations and administrative procedures which already limit (*de jure* and *de facto*) foreign investment in certain industries. As it would not be feasible or desirable to screen all foreign acquisitions of U.S. securities, threshold levels should be established, above which screening would be required. In the case of equities, screening could be required when the participation in the ownership by a foreigner, or foreigners deemed to be acting in concert, exceeded, say, 10 percent of the outstanding voting shares of the firm.

It might also be desirable to consider whether a percentage level should be established at which screening would be required of additional equity purchases by unrelated foreigners.

Foreign loans to U.S. firms would also be subjected to screening whenever any loan exceeded, say, 15 percent of the total long-term outstanding debt of the corporation. Transactions below a floor of, say, $1 million would be exempt from screening.

Screening would apply at entry, and the United States would rely on existing laws to regulate firms after entry. Existing foreign investments would be grandfathered. However, the possibility that foreign-owned U.S. firms, after entry, might make investments in firms in sensitive industries, which would have been covered by the screening procedure, gives rise to the risk that this safeguard against undesirable foreign investment could be circumvented. This loophole could be closed only by subjecting secondary investment by foreign-owned firms unrelated to the primary investment to the same criteria that would apply to the initial investment.

Application of screening to secondary investment, however, would be in conflict with our FCN treaties with a number of important countries, including, among the OPEC countries, Iran and possibly Saudi Arabia.

Screening might apply to investments in such industries as defense, transportation, communications, news media and energy. With regard to defense considerations, one possible approach would be to consider as a defense industry any firm that holds a security clearance to sell goods or services to a U.S. Government agency.

III. Screening Procedure

1. The foreign investor, the U.S. firm being acquired and any other parties to the transaction would all have to notify the Federal screening office of the intended investment. Penalties to force compliance should be imposed.

2. The U.S. Government would have 30 days in which to consider the proposed transaction. If, at the end of 30 days, the parties to the transaction had not been advised to the contrary by the screening office, they would be free to consummate the transaction. However, the consideration period could be extended by notification from the screening office to the parties that the Government needed additional time to consider the proposed transaction.

3. Upon receiving notification of the proposed transaction, the screening office would notify the appropriate U.S. Government agencies. The information, however, would be privileged. The departments and agencies to be notified would vary, depending upon the circumstances.

4. The departments and agencies so notified would have to inform the screening office urgently if they had any objection to the proposed transaction. Any agency might request a delay in consideration of the application and the convening of an interagency committee for discussion of the transaction.

IV. Screening Criteria

The following list of screening criteria is purely illustrative, and much further interagency consideration would be required to develop a definitive list.

(a) Possible effects on national security.

(b) The effect that the intended transaction might have on competition both domestically and internationally to the extent that it would affect the United States.

(c) The likely opportunity to influence public opinion in the United States as a result of the investment.

(d) The foreign policy implications of the intended transaction.

(e) The likely effect on future inward foreign investment.

(f) The importance to the U.S. firm of the transaction, taking into account the financial condition of the firm.

(g) The cumulative result of the proposed investment, including the extent to which this investment increases the exposure of a sector of the U.S. economy to foreign influence or the United States as a whole to foreign influence.

(h) In the case of investments in the form of debt, the extent to which they might give the investor leverage or de facto control in the U.S. company.

V. The screening process would not exempt the investment from U.S. laws, regulations, and administrative practices which would apply to investment in the United States, either by a U.S. citizen or a foreigner. It should be made clear to the foreign investor that he would have to satisfy all legal requirements.

Option 4 - Limit Official Foreign Investment in the United States

An upper limit would be set on foreign official acquisition of the stock and long-term debt of existing U.S. firms, e.g., 10 percent of equity and 15 percent of long-term debt. These limits would also apply to official foreign holdings in newly established enterprises. The limitation would contain a grandfather clause which would exclude forced divestiture or expropriation. This restriction on foreign official holdings would be imposed through new legislation which would include provision for a Presidential national interest waiver to give the Executive Branch adequate flexibility in administering it.

Two complementary elements would be required in conjunction with the imposition of a limit on foreign government investment as a necessary part of this option: (1) a comprehensive reporting and disclosure system for all foreign investment, and (2) prior coordination with the other OECD countries to assure a consistent policy affecting OPEC investments. A third element which would be desirable, would be the creation of a class of investment trusts for foreign governments which would provide them with an attractive alternative to direct holdings of corporate equity and debt. This class of funds would be provided for by legislation and subject to U.S. Government control in a manner similar to that of regulated investment companies for private investors. These funds would serve USG policy purposes by encouraging a broadening of the OPEC investment portfolio. (A policy including this feature is treated as sub-option A and the additional advantages and disadvantages relating to it are treated separately following those regarding the main option.)

Percentile limitations on official foreign investment would conflict with some of our FCN treaties. Accordingly, further study would be necessary to determine how potential treaty conflicts might best be handled, for example, by prior negotiation aimed at avoiding a treaty conflict, by renegotiation of relevant treaties, or by having the legislation exempt treaty countries. The first appendix to this paper contains a discussion of the FCN treaty issue.

If this option should be adopted, it would be desirable to invoke currently available authority to prevent foreign investors from rushing into the U.S. market ahead of the eanctment of legislation. Such authority is found in Section 5(b) of the Trading With the Enemy Act as amended; a legal statement on the Act is attached.

Advantages

-- Deals directly with our principal concern regarding the potential for politically unacceptable influence gained through major investment interest in U.S. firms on the part of OPEC governments.

-- Introduces no new restrictions on foreign private investment.

-- Does not overtly discriminate against OPEC countries.

-- Avoids need for prior screening.

-- Provides guidelines which remove uncertainty regarding reception of OPEC investments.

-- Encourages the OPEC countries to develop broad and diversified investment portfolios.

-- Establishes a basis on which to seek a coordinated consumer country policy vis a vis OPEC investment.

-- Does not require that USG attempt difficult task of making judgments regarding which U.S. industries are vital to our national interest and which are not.

-- Involves the Congress in the establishment of the policy, thus allaying foreign government fears of Congressional repudiation of an Administration policy position.

Disadvantages

-- If applied to all countries, apparently conflicts with a number of FCN treaties (i.e., provision on national treatment for establishment and acquisition). If applied only in absence of such FCN treaty provisions, then issue of OPEC unhappiness over policy aimed almost entirely at them is intensified. (We have no such FCN treaty provision with any OPEC country.)

-- Administration of Presidential waiver provision could be troublesome in terms of foreign government pressures and potential violation of MFN principles .

-- Will be viewed by OPEC countries as aimed specifically at them in attempt to control their investment options, which could lead to some reductions in oil production.

-- Does not cover land sales, per se, which, while difficult to deal with in view of predominate role of State and local governments in land use questions, is a politically sensitive issue.

-- Submission of Administration legislative proposal could attract undesirable restrictive amendments; however, a bold Administration proposal in an area where Congress has expressed concern would appear comparatively invulnerable to the attachment of unwanted "Christmas tree" ornaments.

-- Could result in reduction of investment inflows.

-- Putting percentage limits on long-term investments could force OPEC countries to remain short-term investors, thereby increasing instability of international banking system.

Suboption A - Limitation on Foreign Government Investments Combined with Special Investment Funds for Foreign Governments

A logical adjunct to placing ceilings on direct foreign equity holdings of U.S. firms and of long-term corporate debt would be to create an additional attractive indirect channel for foreign government investment. Details on how such funds might be created and operated are included in the discussion section below. This suboption would present the following additional advantages and disadvantages to those of the main option: (The investment fund could also be used with other options.)

Advantages

-- Provides an additional channel for foreign official investment at the same time that direct holdings are being limited.

-- Is consistent with our goal of broadening the distribution of foreign government, particularly OPEC, investment and thereby limiting the extent to which oil producer investment is translated into political power.

-- Congressional approval is likely to be required to establish the investment funds; as a result such funds would have a Congressional blessing which alternative investments would not have.

Disadvantages

-- OPEC Government receptivity is not known and could be negative.

-- Any appearance of giving incentives to government investors would be criticized at home and in other non-OPEC countries; conversely, omission of incentives would reduce the attractiveness of the funds as an alternative investment channel.

-- Making the funds in effect a favored avenue for foreign government investment could be criticized within this country as being contrary to normal U.S. Government-business relationships.

-- The funds would be powerful and influential forces and could have an unpredictable impact on international financial and equity markets.

Discussion

The proposed ceiling on direct foreign official holdings would actually affect very little OPEC investment based on our experience so far. Thus, it is aimed at potential rather than actual investment patterns.

With regard to possible conflict with FCN treaties it might be possible to make a case that the intent of those treaties was to deal with private not government investment. However, to avoid apparent conflicts with U.S. treaty obligations, we are excluding from the limitation countries with FCN provisions calling for national treatment on establishment and acquisition, while still covering all the OPEC countries. New FCN treaty negotiations would have to take the effect of this policy option into account by excluding government investment from a national treatment provision.

In addition to OPEC states, certain OECD states with whom we do not have FCN treaties (for example, the U.K., Canada and Australia) would also be affected. However, we do not anticipate massive official investment from those countries, and we would anticipate no special problems arising as a result of this.

The investment funds contemplated under the suboption would be subject to some limitation on the percentages of equity or debt that they could hold in a single company. Each such fund would be required to have separate management and no collusion among them would be permitted. Their use would be optional and in no way limit the choice of investment channels open to OPEC. Further, management of the funds would be divorced from direct control by foreign governments and would be independent of them in the exercise of voting rights obtained through the fund's equity holdings.

There should be no limit on foreign governments' indirect holdings of equity through participation in more than one of these specially created investment funds, since the dilution of control which would be provided by this device would be adequate protection against undue influence. Thus, a foreign government might participate in investment funds that together hold substantially more than 10 percent of the stock of a particular corporation. In that way, foreign governments could enjoy the economic benefits of a major shareholder while being divorced from management control.

Creation of such investment funds would have to be handled carefully in order to give them some appeal to foreign official investors, without providing undue special incentives. This could be accomplished by emphasizing the acceptability of such investments, a factor which is of particular importance to government investors. The establishment of such funds would probably require Congressional action, and legislation would give foreign governments Congressional blessing for such investments which they would not otherwise obtain. In a situation where the attitude of the U.S. Congress is a major uncertainty for foreign investors, such a blessing would be an important factor. Further, the existence of limits on direct foreign government holdings will itself act as an incentive to the use of the investment funds.

Coordination of consumer country policies toward foreign government investment would be essential for the success of this option and suboption. This would involve (1) coordinated arrangements for setting up the investment funds, (2) parallel registration and disclosure requirements, and (3) parallel limitations on direct foreign government holdings of equities and long-term corporate debt. This could be accomplished within the IEA or the OECD.

Uncoordinated consumer country inward investment policies could produce a snowball effect in which restrictions on OPEC government investment by one country could divert massive funds to another consumer country which would then be forced to enact even tighter restrictions. The end result could be a general level of investment restrictions so high that OPEC countries would be encouraged to cut back on oil production. The absence of coordination could also result in a channeling of OPEC investment to the consumer countries with weakest economies, such as Italy, which could not afford to match high levels of restrictions, and would thus give the OPEC countries very significant economic and political leverage in those countries.

Suitable vehicles are available for early discussion of these issues in the IEA and the OECD, (e.g., the inner group of the XCSS meets in February, the new OECD investment committee will meet in February, and a new IEA financial group is about to be formed). Any unilateral modification of any of the consuming countries investment policy without consultations would threaten the unity of the group vis a vis the oil producing countries.

There have been clear indications that the oil consuming countries are willing, in fact anxious, to develop a coordinated strategy with regard to OPEC investments, and it is noteworthy that our Embassy in Bonn has reported that German Finance Minister Apel has publicly stated that OPEC investments have raised the requirement for serious vigilance and possibly legal barriers. He stated that there are limits to the amount and types of direct investment which the German Government would permit within the Federal Republic.

The reporting and disclosure system called for under this option may or may not require additional legislation depending on whether a comprehensive and effective system can be created from existing authority and reporting requirements. In any case, the reporting system could be put in place before action is completed on the other elements of the option.

B

7

February 6, 1975

Survey of Laws and Regulations on Foreign Investment and Safeguards Against Undesirable Behavior by Foreign Investors

General Considerations

At the microeconomic level, the general U.S. policy of non-intervention in foreign investment in the United States is based on the proposition that it contributes to the dynamism of the American economy by stimulating competition and seeking out new investment opportunities. Thus, government intervention is called for only in cases where there is a strong presumption that the market outcome would be socially undesirable. Whether this proposition is valid is dependent on the assumption that foreign investors are motivated essentially by economic factors and that their over-all motivations are basically the same as those of U.S. investors. To the extent that non-economic factors might, however, influence investment decisions, it is prudent and essential that the United States have safeguards against foreign investments that find their motivation outside the market. Since such safeguards are not without cost, the question comes down to the optimal trade-off between the cost of current or additional safeguards on the one hand and the danger to the national interest of doing without such safeguards on the other hand.

Safeguards can be divided into two basic categories: Active (before the fact) and passive or standby (after the fact). That is, safeguards can be designed to forestall foreign investments which are presumed to be inimical to the national interest or designed to neutralize or counteract foreign investments which are found in practice to be inimical to the national interest . Surveillance of foreign investment can also be considered a safeguard, in that it can serve to alert the authorities to the need or possible need for action in the form of activating existing powers to take the appropriate measures or to seek the necessary authority from the Congress.

For analytical purposes, all current or potential safeguards fall into one of the following categories:

Active safeguards

Advance notice of intended investments (registration)

Restrictions

a. on a case-by-case basis (screening)
b. on the basis of predetermined and announced criteria.

Passive or standby

Comprehensive and detailed reporting

Authority to counteract, to be applied on an *ad hoc* basis

The basic argument for predetermined restrictions on foreign investment is, in essence, that an ounce of prevention is worth a pound of cure. Even where standby safeguards exist, it is argued that considerable damage could be done before the unwanted investment is detected and the process of counteraction is implemented.

A fundamental difficulty of this approach is the problem of making valid judgments on the desirability of the various kinds of foreign investments before the fact. At the microeconomic level, it is the manner in which foreign investors exercise the privileges, powers and leverage accompanying ownership rather than the fact of ownership that is relevant. For example, a foreign interest in a "critical" or "key" company can be exercised in a passive and benign manner with no ill effects while a foreign interest in a noncritical, e.g. consumer products, company can be exercised in a highly disruptive manner.

Meaningful evaluations of individual companies or industries from the standpoint of being "key" or "vital" to the national interest are difficult and obviously controversial. Companies or industries that might fit such classification today may be common within a few years, given the rapid and unpredictable advance of technology. An effort to keep restrictions current on foreign investment in "key" or "vital" industries would require continuing determinations respecting companies or industries clearly and directly vital to national defense, and there would be no logical stopping point. Moreover, arguments for restrictions based on purely protectionist and other considerations not related to the national interest would undoubtedly be advanced in terms of the national interest, and the process could lead to an ever widening array of restrictions against foreign investment.

Granting this, it could be argued that, since investment in a company increases the potential for misusing the company, this potential should be minimized in cases where misuse would be particularly damaging to the national interest. To forestall this contingency, there are currently Federal restrictions which limit foreign investment in certain industries, such as atomic energy, aviation, shipping, and communications. Also, Defense Department regulations act as an indirect prohibition on foreign acquisition of any firm that does classified work for the Government in that such acquisition could cause the firm to lose such contracts.

In the case of the few U.S. companies where a foreign takeover would be patently intolerable, the provocative nature of the action should be as obvious to potential foreign investors as it is to ourselves. Given the remedies which are available to this Government, it is debatable that any foreign investors would want to risk retaliation. Thus, one might legitimately ask whether the added safeguards justify the unsettling effects on the U.S. and foreign business community which would arise from a registration requirement or additional active safeguards on inward foreign investment.

A number of Federal and state laws and regulatory constraints assure that economic activities of companies are consistent with national and/or community interests. Some of the more important of these are antitrust laws, export controls, SEC laws, the National Labor Relations Act and state laws giving certain protections to minority shareholders against majority shareholders. These and other constraints apply equally to foreign and U.S. owned companies. Thus, potential abuses of economic power by foreign owned companies are already heavily circumscribed. In addition, depending upon the circumstances the Federal Government has broad powers--in the Trading With the Enemy Act, the Defense Production Act, and the Selective Service Act--to control and regulate the activities of companies in the interest of national security and to deny access to defense secrets by any firm under foreign ownership, control or influence.

This formidable array of safeguards against undesirable behavior by foreign-owned firms is adequate for the present. Such "chinks in the armor" as foreign investors might discover and attempt to exploit are best dealt with when and if these contingencies arise. There is no reasonable likelihood that a significant amount of damage to the national interest could be done before the Congress passed corrective legislation. Also, it is a moot question as to which, if any, of the various kinds of possible activities not covered by current safeguards would be contrary to the national interest. This is the "gray area" on which it would be difficult to reach a consensus, particularly in the abstract or before the fact.

In regard to the adequacy of the information presently available to the Federal Government on inward foreign investment, "adequacy" obviously depends on what the Government considers that it needs to know and how the data would be used. The answers to these questions will determine whether aggregated or disaggregated data are needed as well as the amount of detail on individual investors.

Present reporting requirements of various Federal agencies produce information which, if assimilated in one place and thoroughly analyzed, could produce a more comprehensive, detailed picture of foreign investment on a flow basis than is presently available. The major pieces of this over-all reporting net are the Commerce Department (direct investment), the Treasury Department (portfolio investment) and the SEC (acquisitions of more than 5 percent of the stock of a company whose securities are publicly traded). Other regulatory agencies and the DOD also collect information on foreign investment in U.S. companies subject to regulation by them. Moreover, the benchmark surveys being undertaken by the Commerce and Treasury Departments, by late 1975 or early 1976, will yield a comprehensive census of all longterm foreign investment as of end-1974. This information will become dated over time since the flow data collected by the Commerce and Treasury Departments are not collected on such a detailed basis. However, if these flow data, along with data from various other agencies, particularly the SEC, which collect information on foreign investment are carefully restructured, it would be possible to continue to have an up-to-date, detailed picture of foreign investment in the United States.

Some observers believe that an important information gap exists relating to the identity of foreign investors. When foreign investors use nominees to acquire and hold U.S. securities our records may show only the holder of record rather than the beneficial owners of the securities. The extent to which this is the case is not fully known but in any case there is a difference of opinion as to how meaningful or necessary it is to know the identity of beneficial owners or their country of residence, or just how meaningful ownership is in terms of control over corporate activity. The SEC is presently inquiring into many of these issues and may recommend changes in legislation or practice.

I. Introduction

U.S. policy on international investment has been based on the belief that the free flow of capital across borders in response to market forces best served U.S. interests. Thus, this country has tradionally based its investment policy on freedom of investment and has neither offered special inducements to foreign investors nor put barriers in their way beyond those necessary to protect national security and other essential interests.

The recent larger accumulation of funds by oil-producing countries has given rise to Congressional and public interest in the possible scale, direction, and effect of foreign investment in this country. That much of these accumulations is in the hands of officials rather than private foreign investors, who might be motivated by noneconomic factors, gives rise to some concern.

In light of the widespread interest in the impact of inward foreign investment in the United States, a review of the information currently available to the Federal Government on foreign investment in the United States and the existing legal restraints and power regarding this investment is made in the first part of this paper. The next sections of the paper discuss the possible misuses of U.S. companies by foreign investors and the various restrictions which we have and other safeguards which have been proposed. The final sections give an overall assessment of the potential dangers and safeguards and conclusions regarding the need for additional safeguards.

II. Current Information on Foreign Investment

A. Foreign Investment in U.S. Enterprises: Book value (equity and debt) of foreign direct investment in the United States at the end of 1973 was $17.7 billion while the estimated market value of foreign portfolio holdings of corporate securities was $36.8 billion. The comparable figures for U.S. investment abroad are $107 billion and $25.2 billion respectively. Total direct and portfolio equity investment in the United States by foreigners amounted to about 4 percent of the value of outstanding U.S. stock at the end of 1973. About half of the direct investment is in manufacturing and one quarter in petroleum.

Equity investment in the United States by foreigners was of relatively low magnitude in 1974. Data for the full year are not yet available, but the increase in the equity portion of direct investment was only $500 million in the first half of the year and net purchases of U.S. stocks for portfolio investment were less than $400 million in the first ten months of the year. The inflow of this type of investment in 1974 was substantially less than in 1973 when equity investment was $1.5 billion for direct investment and portfolio purchases were $2.8 billion. Even in 1973 when direct investment (equity and debt) was as large as $2.5 billion it was still a small factor in the $152.2 billion of domestic non-residential investment.

Eighty percent of the foreign direct and portfolio investment in the United States comes from Canada, Europe and Japan. We have no way of determining, however, the extent to which the beneficial owners of the securities may be residents of other areas.

B. Reporting of Ownership for Statistical Purposes: Foreign investments in U.S. stocks are collected for statistical purposes and balance of payments presentation by the Departments of Treasury and Commerce.

The Treasury collects data on a monthly basis from over 200 reporters on transactions in U.S. corporate stocks including new issues, redemptions, transactions in outstanding securities and some direct investment. The gross sales and purchases of foreigners are published monthly in the Treasury Bulletin with a country breakdown. Data on individual investors are not collected.

The Commerce Department has collected, on a quarterly basis, data on foreign equity investment in U.S. firms, when the foreign participation exceeds 25 percent of their outstanding voting stock and is over $2 million in the equity and debt accounts. Beginning with the first quarter of 1975, the participation threshold for reporting will be dropped from 25 to 10 percent. The identity of the individual foreign investor and the U.S. company is kept confidential within the statistical section of the Department of Commerce. Statistics are published quarterly in the Survey of Current Business. Commerce also publishes annually an estimate of the outstanding value of foreign portfolio holdings of U.S. stocks.

In addition to the on-going reporting programs of Commerce and Treasury to collect data on the flow of foreign investment to the United States these agencies are undertaking one-time benchmark surveys of foreign investment outstanding as of end-1974. The data from these surveys, which will be partially available by October, 1975 and in greater detail by April, 1976, will show foreign investment in every U.S. company of significant size broken down by kind of investment and kind of investor by country of residence.

C. Reporting of Ownership for Regulatory Purposes:

The Securities and Exchange Commission requires reports designed to warn of substantial changes in ownership and control of publicly held and traded corporations having assets of $1 million or more and five hundred or more stockholders. Any person, American or foreign, who acquires ownership of a registered equity security of 5 percent or more of the amount outstanding, must report detailed information on the transaction and the purchaser within ten days to the issuer of the security, each exchange in which the security is traded and the Commission. After a 5-percent acquisition, such person would be required to file further reports whenever his acquisition exceeded 2 percent in any 12-month period. The same reporting requirements apply to tender offers which would result in ownership of 5 percent or more. The filing must be made at the time the announcement is made public. Moreover, every person who is owner of 10 percent or more of a registered equity security must report any changes in ownership over the 10 percent level ten days after the close of each month. Only the name and address of the holder are required. Directors and officers of the corporation must give their holdings no matter what the percentage is.

Failure to comply with the reporting requirements of the SEC, carries a maximum penalty of a $10,000 fine and up to 2 years in prison. If it can be proved the person was unaware of the requirements only a fine is levied.

The names of companies and amount of shares involved are listed for the 5 percent holdings and tender offers in the SEC Statistical Bulletin. The detailed reports filed by firms are available for public inspection at the SEC Public Reference Room. U.S. and foreign firms are required to identify beneficial owners and to disclose other relevant information in such filings. When intermediaries are used, the beneficial owners are still required to be disclosed, although this might not occur in all instances.

Other Federal regulatory commissions generally require reports on ownership when permits are requested and annually thereafter; these reports are open for public inspection and copying. The commissions also require reports on the debts which includes the identity of individual creditors in many cases.

The Federal Maritime Commission asks water carriers for the top 30 security holders and their voting powers and holders of 5 percent or more of each class of stock. Freight forwarders need identify only stockholders (including citizenship) who individually own or hold 5 percent or more of the stock.

The Federal Communications Commission requests reports on holders of 3 percent or more voting interest in broadcast companies, and generally makes supplemental requests regarding voting rights down to 1 percent. Common carriers of communications, however, need report the 30 largest holdings of each class of stock to the FCC.

The Federal Power Commission asks public utilities and natural gas companies for the 10 stockholders with the highest voting powers and the number of votes each could cast at a stockholders meeting.

The Interstate Commerce Commission asks for identification of the security holders with the highest voting powers -- the top five in the case of railroad lessors, the top 10 in motor carriers and the top 30 in railroads.

The Civil Aeronautics Board requires the names of stockholders holding more than 5 percent of the capital stock of a U.S. air carrier. The trustees and nominees holding 5 percent of the stock are required to give the names of the stockholders for whom the stock is held and who have the power to vote the stock. In addition, banks and stockholders must report the identity of any person where the account contains 1 percent or more of the stock.

The Department of Defense requires each contractor to submit a Certificate Pertaining to Foreign Affiliation to meet the DOD Industrial Security Regulations. If the total foreign ownership is above 6 percent, the firm must identify the individual owners. This can be difficult because of the use of nominee account by stockholders. However, the Defense Department is more concerned with foreign control, than ownership, and once this control is exerted by foreigners, the U.S. management is aware of it and notifies Defense.

The Treasury Department requires, under the Federal Alcohol Administration Act, applicants for permits to produce and distribute beverage liquors to submit details on their identity and keep the Department informed of any change in ownership. In the case of corporations, persons owning 10 percent or more of the voting stock must be identified, in addition to the directors and officers. If a foreigner is identified, the Treasury Department obtains background information, including criminal records from police authorities abroad.

D. Beneficial Ownership: The ability of the reports on ownership to identify foreigners depends on the degree to which the commissions dig behind the listing of nominees to determine the "beneficial owner," i.e., the person who has the power to vote or directs the sale of securities. According to a report by the General Accounting Office in 1973, it appears, that for large regulated companies, the names of nominees are often shown in lieu of stockowner names in reports to regulatory agencies.

The problem of beneficial owners was among those covered at the SEC "takeover" hearings that were held in December on the general adequacy of the present filing requirements outlined above. The SEC staff is expected to make recommendations to the Commission this spring on possible improvements in the disclosure requirements under the 5 percent reporting requirement and possible reduction in the reporting level to 1 percent ownership, amongst other changes.

Even if the regulatory commissions required domestic nominees to disclose the owner for whose account the stock is held, a foreigner could use a nominee located in a foreign country. Although the percentage of foreign ownerships could still be determined, the actual identity of the foreigner could not. Requiring their identity would involve a problem of legal jurisdiction. Some countries such as Switzerland prohibit the provision of such information by banks.

III. Existing Legal Restraints and Powers of USG to Control Foreign Investment

This section outlines key Federal laws and regulations (1) restricting foreign investment in the US or (2) controlling or regulating the conduct of foreign controlled business activity. In addition to these Federal controls, a number of state laws provide additional regulation and safeguards.

From this survey it appears that there is minimal danger that foreign investment in the United States can be used in a way detrimental to our national interest because of the protections afforded by (1) general laws to insure against abuse of economic power and (2) specific legislation dealing with foreign investment.

A. Laws of General Application

Every foreign investment is subject to the same laws and regulatory constraints which control United States business. It is this factor -- i.e. pervasive general laws to ensure that all economic activity is conducted in our national interest -- that provides us with the most protection against potential misuse of control by foreign investors. A few of the more important of these laws are summarized below.

1. Antitrust Laws -- The antitrust laws contain no specific prohibitions on foreign investment. However, they apply equally to U.S. and foreign corporations and prevent a foreign investor from (a) illegally monopolizing a specific sector; (b) engaging in various anti-competitive practices; or (c) making a purchase of, or engaging in a merger or joining venture with, a U.S. firm if the result would be to substantially lessen competition or tend to create a monopoly. The laws have wide application -- applying to any act affecting U.S. foreign commerce -- and both the Justice Department and the FTC interpret their powers broadly. The FTC has particularly broad investigatory powers and requires prenotification of mergers of a certain size.

2. Export Controls -- Although export controls do not restrict foreign investment in the U.S., they are an important tool in ensuring that a foreign investor does not use his U.S. investment to drain essential resources from our economy. The Export Administration Act prevents the export of U.S. resources when (1) national security is threatened or (2) there is an excessive drain of scarce materials and a serious inflationary impact from foreign demand or (3) controls are needed to further U.S. foreign policy. The Commerce Department is required to monitor exports when such exports would lead to a domestic price increase or a shortage which would have a serious impact on the economy. (See National Defense and Energy sections below for special controls on armaments and energy exports).

3. SEC Laws -- While the SEC laws do not prevent foreign investment, they do require disclosure of significant foreign investment (by beneficial owner) and are designed to regulate potentially harmful activities. SEC regulations re tender offers, shareholder disclosure requirements, stock price manipulation and preservation of an orderly market make no fundamental distinction between domestic and foreign investors and apply equally to both types of investor.

4. Industrial Relations -- The National Labor Relations Act and other labor laws apply to all firms operating in the United States to prevent unfair labor practices (e.g. runaway plants and arbitrary dismissal or treatment of workers). All industrial plants must comply with federal laws designed to assure every worker in the United States safe and healthful working conditions.

5. Rights of Minority Shareholders -- Most state corporation laws, as well as the common law, provide protection for minority shareholders against irresponsible action by majority shareholders. Experience indicates that these rights can be used to help prevent abuse of power by a controlling foreign shareholder. For example, if a foreign investor tried to use his control of a United States firm to destroy or disrupt for political purposes, minority shareholders could sue to enjoin such action.

6. General Control by Regulatory Agencies -- All investors (domestic as well as foreign) operating in certain critical sectors of the economy are regulated by one or more regulatory agencies (e.g. FPC, ICC, CAB, FMC, AEC, SEC, FDA, REA) or by special laws dealing with that sector (e.g. Public Utility Holding Company Act or Bank Holding Company Act).

B. Broad Emergency Powers

1. Trading With the Enemy Act -- This Act gives the President the power (during a war or national emergency) to completely control foreign owned interests in property in the United States. There should, however, be a connection or nexus between the emergency and the action taken.

2. Control of Enemy or Hostile Alien Assets -- Various regulations permit the government to regulate or prohibit all transactions (including investment in the United States) involving certain listed "enemies or hostile aliens." Although the list is now limited (PRC, North Vietnam, North Korea, Cuba) it could be extended to include any other nation without legislation.

3. Condemnation Power -- The United States Government has the basic power to condemn any property within its jurisdiction if it is done for a proper public purpose and just compensation is paid.

4. National Defense Powers -- See C-2 below for special Presidential powers relating to national defense needs.

5. Emergency Legislative Action -- The Congress always has the power to control or prevent any clear and present threat to our national or economic security by immediate legislative action which the Executive Branch could request.

C. National Defense

1. Any activity involving classified contracts -- Under its Industrial Security Regulations the Defense Department may deny security clearances required to do classified work for the United States Government to any firm under "foreign ownership, control or influence." The regulations do not directly prevent foreign ownership of producers of defense items but only provide protection against foreign access to classified information that could be gained by a company contracting with the United States Government. However, they do act as an indirect prohibition on foreign acquisition of any firm that does classified work with the Unted States Government in that such acquisition could cause the firm to lose its classified government business.

2. Priority Performance Powers -- (A) The Defense Production Act gives the President power to (1) require the priority performance of defense related contracts and (2) allocate materials and facilities necessary or appropriate for the national defense. (B) The Selective Service Act provides that, if the President determines it is in the interest of national security and if Congress has authorized funds to procure a particular product, the President has power to place priority orders for that product and take possession of the facility if they are not fulfilled. (Note: There are legal questions as to whether these acts give the President the power to prevent plant closure or to require the continuance of defense related business).

D. Energy

1. Energy Export Controls -- In addition to general export controls which could be used to prevent all energy exports, the FPC regulates the export of natural gas from the United States and issues a permit only if the export is in the national interest. In addition, the Federal Energy

Act requires FEA to monitor exports of coal, crude oil, residual oil or any refined petroleum product.

2. Atomic Energy -- The Atomic Energy Act prohibits licenses for the operation of atomic energy utilization or production facilities to be issued to aliens or foreign owned or controlled corporations. There is no similar prohibition for fabrication of fuel elements, uranium mining or melting or activities involving radioactive isotopes. However, all of these activities are highly regulated by the AEC which can prohibit activities in there areas which are "inimical to the nation's welfare."

3. Mining and Drilling in the United States -- There are certain restrictions on foreign controlled corporations mining and drilling for coal, gas, oil etc on federally owned lands. See E-1 below for details.

4. Regulation of Pipelines -- With respect to pipelines on federal lands, foreign controlled corporations can own an interest only if their home country grants reciprocal rights to United States companies. With respect to pipelines on non-federal land, foreign investors are not precluded from ownership or control but are subject to ICC and FPC regulation.

E. Natural Resources

1. Mineral Resources -- Under the Mineral Leasing Act of 1920, aliens cannot hold any interest in a pipeline or a mineral, coal or oil shale lease on federal lands. However, foreign controlled corporations may hold such interest if their country grants reciprocal rights to United States companies. There is, however, no prohibition on a foreign controlled corporation holding a lease to (1) drill on the United States outer continental shelf; (2) operate under Geothermal Steam Act or (3) locate and mine uranium under the Mining Law of 1972. Such corporations would be subject to the terms of these acts and to the specific terms of the leases granted to them.

2. Fishing -- Transfer of control to a foreign investor of a United States fishing company or a United States shipyard engaged in the construction, maintenance or repair of fishing vessels must be approved by the Maritime Administration. There are also other minor restrictions -- e.g. no fishing by aliens in Alaskan waters and no alien fishing vessels can land catch in the United States.

3. Land -- (a) Federal Land: The Alien Land Law prevents foreign ownership of federal public land except by foreign controlled United States corporations whose parent country grants reciprocal privileges to United States citizens. (b) State Land: A few states have restrictions on foreign ownership of land under their jurisdiction.

F. Communications, Media and Dissemination of Foreign Propaganda

1. Communications and Media: Foreign investment in the United States communications and media sectors is controlled by the Federal Communications Act which (1) prohibits (with minor exceptions) aliens or foreign owned or controlled United States corporations from receiving a license to operate an instrument for the transmission of radio communications (2) prohibits the FCC from approving a merger among telegraph carriers which would result in more than 20 percent of the capital stock of the carrier being controlled by a foreign entity; and (3) closely regulates all common carriers engaged in interstate or foreign communication by wire or radio.

2. Foreign Propaganda and Political Activity: The Foreign Propaganda Dissemination Act requires any United States corporation (e.g. a newspaper or magazine) which is controlled or financed by a foreign entity to file a registration statement with the Attorney General if it carries on any activity in the United States intended to influence United States domestic or foreign policy or promote the interests of a foreign government. While there are exemptions for diplomats, nations deemed vital to our national defense and various non-political activities, the scope of the law is broad and requires registration, filing and disclosure with respect to a wide range of political propaganda disseminated in the United States on behalf of foreign interests.

G. Transportation

1. Aviation -- Foreign investment in the aviation sector is regulated by the Federal Aviation Act which (a) limits the persons who may carry passengers and cargo within the United States to United States citizens and United States controlled corporations and (b) requires CAB approval for any foreign air carrier or any person controlling a foreign air carrier (e.g. a foreign government) to acquire control of any United States citizen engaged in any phase of aeronautics.

2. Maritime and Shipping -- Foreign investment in the United States maritime industry is restricted by a series of laws which (1) limit ownership and operation of certain vessels to United States citizens; (2) prohibit transfer or mortgage of United States vessels, shipyards, drydocks or ship repair facilities to non-United States citizens without Secretary of Commerce approval; (3) prevent non-United States citizens from receiving construction or operating differential subsidies and (4) limit United States coastwise trade to vessels owned by United States citizens. No corporation is a United States citizen unless (a) the controlling interest is owned by citizens of the United States and (b) the chief executive officer, board chairman and a majority of the quorum of directors are United States citizens.

H. Banking and Finance

1. Banking -- Because of the dual banking system in the United States, most foreign banks have chosen to establish in the United States under state charters and, therefore, are controlled by state law. Only ten states permit foreign banking activities in the United States and those that do (e.g. New York, California and Illinois) closely regulate them. Depending on the nature of the state charter and the nature of the bank's activities, foreign banks may be subject to regulation by the Federal Reserve Board and the FDIC and may be controlled by general legislation like the Bank Holding Company Act. In addition, the Federal Reserve proposed legislation in the 93rd Congress (S. 4205) providing for federal licensing and regulation of all foreign banking activity in the United States; and the Board plans to have it reintroduced in the current session of Congress.

2. Insurance -- There are no restrictions on foreign alien or corporation ownership of insurance companies although five states do prevent foreign governments from owning insurance companies. Most states have special requirements for foreign controlled insurance companies -- including mandatory establishment of trusteed deposits up to the amount of the company's outstanding liabilities. Many states have citizenship requirements for directors and all states license and closely regulate insurance activities in their state.

3. Securities Industry -- The SEC, the NASD and most stock exchanges do not restrict or prohibit ownership of brokerage houses by aliens. However, foreign as well as

domestic investors are subject to the same SEC, NASD and stock exchange regulations as domestic investors. The NYSE does, however, impose limits on foreign ownership of its members. The Trust Indenture Act of 1939 requires that at least one trustee under a qualified trust indenture be organized under the laws of the United States.

I. Agriculture

Although there are no specific prohibitions on foreign investment in agriculture, foreign citizens and foreign controlled corporations are denied the benefits of many programs relating to agriculture. For example, Farmers Home Administration loans for rural housing are limited to United States citizens; and grazing on public lands is regulated by the Forest Service and the Bureau of Land Management. In addition, the Export Administration Act described above could be used to prevent export by foreign investors of food and other agricultural products needed in the United States.

Various agencies (e.g. the Food and Drug Administration and the Meat Inspection Division of the Department of Agriculture) administer a number of acts designed to maintain food standards and protect the public from misleading marketing practices.

J. Special Aspects of Foreign Government Investment

Most United States laws make no distinction between investment in the United States by foreign private entities or investment by foreign governments or governmental entities. This means that the bulk of the restrictions and regulations outlined above apply to investment in the United States by foreign governments and, where relevant, prevent or regulate activities of foreign governmental investment in the United States. There are, however, a few areas in which foreign government investment is treated differently. These are outlined in this section.

2. Sovereign Immunity -- The United States follows the so-called restrictive theory of sovereign immunity which means that a foreign government engaging in public acts would be immune from suit in the United States but not when engaged in commercial acts. Thus, foreign governments should not expect sovereign immunity to protect them from suit with respect to most investment in the United States. There are, however, some minor problems concerning (1) the lack of a

statutory procedure for service of process; (2) immunity of a foreign government from execution of a judgment and (3) the fact that the State Department and not the courts determine factual and legal questions about the validity of a foreign government's claim of sovereign immunity. These problems would, however, be eliminated by a State/Justice proposed bill which would incorporate the restrictive theory into statute, provide a method for service of process, limit immunity from execution and transfer the task of determining whether a foreign state is entitled to immunity from the State Department to the courts.

3. Reporting Requirements -- Existing reporting requirements relating to the collection of foreign direct investment data apply to foreign governments. However, the Bureau of Economic Analysis in the Commerce Department indicates that the reporting regulations are rarely observed by companies in which a foreign government has a controling interest and that the United States Government presently has no way of enforcing them against a foreign government or government controlled investor.

4. Tax Law -- Foreign governments are generally exempt from taxes on investment in the United States. However, the exemption does not apply to the income of a separate profit-making corporation, wherever organized, which is owned by a foreign government. Distributions to the government from such corporations would, however, be tax free.

5. Antitrust Laws -- There is a technical legal issue over the application of our antitrust laws to foreign governments. American courts have held that the Sherman Act does not confer jurisdiction on United States courts over acts by foreign sovereigns and that only acts by persons and corporations are covered. Thus, the key factor in any determination as to the applicability of United States antitrust laws to the investment activity of a foreign government would be whether it used a separate corporation of the type generally engaged in commercial activity.

6. SEC Laws -- No differentiation is made between foreign governments and other foreign investors by federal laws concerning investment in United States securities. This means that the reporting and disclosure requirements of the Securities Exchange Act of 1934 do apply to foreign governments and foreign government controlled corporations. There are, however, special regulations relating to the government issuance of securities in the United States.

IV. Potential Misuse of Foreign Investment in U.S. Firms

This section outlines some of the potential dangers which might arise from foreign control of individual U.S. firms. Although it deals with possible abuses of economic power by foreign investors, there is no inference on the part of the U.S. Government regarding the likelihood of such abuses. They are listed as representative possible abuses. Many would involve substantial economic cost to the foreign investor and would occur only if he was substantially motivated by political and not economic objectives.

A. National Security. A foreign investor may use his control over a US corporation in a way contrary to US national security interests.

Danger	Existing Protection
1. Acquire US defense manufacturer.	1. DOD Industrial Security Regulations protect against access to classified material and act as indirect prohibition to acquisition of defense manufacturer. Depending on the precise nature of the acquired business, approval of a US regulatory agency may be required. Finally, the Foreign Assets Control Regulations prevent acquisition by nationals of hostile nations.
2. Move US defense manufacturer abroad	2. Existing regulations prohibit unapproved export of classified technology related to defense manufacture. Also, facility clearance for classified work will not be granted to contractor activities outside the US.
3. Obtain access to classified information.	3. DOD Industrial Security Regulations provide broad protection.

4. Slow down production process or refuse to supply in the event of national emergency.	4. The Selective Service Act and the Trading with Enemy Act give the President powers he can use to require priority orders to be filled or to take over a plant in certain circumstances. In addition, many state corporation laws would give minority shareholders rights if irresponsible corporate action were taken to the detriment of profits.
5. Foreign influence over US firms might cause a US company to deal with a foreign sovereign in a way contrary to US security interests. (e.g. compromise during negotiations re nationalization or price or supply.)	5. No effective protection except that US corporation is subject to all US laws regulating economic activity which would put some limits on foreign influence in negotiations with foreign entities.

B. <u>Economic Interests</u>. A foreign investor may operate a firm in a way contrary to US economic interests by (1) depriving the US of productive capacity; (2) introducing foreign management practices or (3) failing to take a pro US line in negotiations with foreign nations.

Danger	Existing Protections
1. Deprive US of productive capacity by : a. buying a plant and closing it or moving it abroad b. letting the plant depreciate c. cutting essential expenditure like R&D d. selling off key assets	1. There is no single, specific protection against these types of actions. However, such action (a) would involve substantial economic cost (b) create problems with labor contracts and union rights and (c) could constitute an antitrust or SEC violation if done for anticompetitive reasons or if control was obtained via tender offer and intention to close or move abroad was not disclosed. In addition, export controls could be used to prevent movement of equipment and technology abroad. Lastly, minority shareholders

Danger	Existing Protection
	would have rights under certain state corporate laws to prevent irresponsible corporate action by majority shareholders.
2. Introduction of alien management practices	2. US workers have some protection under collective bargaining contracts (if unionized) and existing labor laws prevent unfair labor practices.
3. Foreign influence over a firm might cause the company to take actions in dealing with foreign nations (e.g. in nationalization or price or supply negotiations) contrary to US interests.	3. See A-4 above.

D. <u>Natural Resources</u>. A foreign investor might use his investment in a way that would (1) deprive the US of essential natural resources or (2) retard the development of our natural resources.

<u>Danger</u>	<u>Existing Protection</u>
1. Drain scarce materials from the US (e.g. food, energy or critical minerals and resources).	1. Existing export control laws provide for monitoring and controls in cases where export would have an inflationary impact, lead to domestic shortages or threaten our national security.
2. Foreign owners sit on land or leases and not develop the resources.	2. President has power under the Selective Service Act, Defense Production Act and Trading with the Enemy Act to require priority orders or to take over a mine in certain circumstances.

E. Foreign Investor as Creditor. A foreign creditor might use his influence as a creditor to gain control over assets of a US debtor corporation.

Danger	Existing Protection
1. Influence disposition of assets in liquidation or bankruptcy.	1. U.S. bankruptcy laws and laws of creditors rights put some limits on extent of foreign debtor influence.
2. Power to accelerate loan, exercise security interest, etc. in event of default.	Debtor influence can be minimized by careful drafting of loan documents, requiring subordinated indebtedness, keeping foreign percentage below "blocking percent" under indenture, etc. Also use of U.S. trustee and need to comply with provisions of Trust Indenture Act of 1940 in cases of publicly held debt.
3. Debtor consent can be withheld to block acquisition or disposition of assets, merger, management changes, reorganization, etc.	

F. Competition. A foreign investor may use his economic power to (a) gain a monopoly or unfair competitive position in key US industries; (b) engage in predatory pricing or conduct or (c) gain an undue concentration or accumulation of economic power.

Danger	Existing Protection
1. Individual country gains control of key industry.	1. Antitrust laws would prevent abuse of monopoly power
2. A group of countries (or individuals) gains control of a key industry.	2. AT laws should prohibit--especially if act in concert.
3. Foreign investor's US activities give strong market power and perhaps competitive advantage (e.g. vertical integration) when combines with its foreign activities.	3. If use monopoly power or restrain trade, AT laws should protect.

Dangers	Existing Protections
4. Economic motives lead to try to drive competitors out of business, improve market position or gain a monopoly.	4. No different than activities of some domestic investors and existing AT laws (e.g. Robinson-Patman and laws re unfair competition) should protect.
5. Political motives lead investors to retaliate against companies which deal with enemies of the foreign investor country.	5. AT laws should protect but check (a) technical problems re application of AT laws to governments and (b) enforcement problems re service of process and levy and execution on assets if enterprise is owned by a foreign government.
6. No antitrust violation but a rather pervasive influence in US economy because of widespread investments a. Foreign private investors b. Foreign government investors.	6. No real protection except a series of older laws limiting the extent of foreign investment in key sectors.. Some control (query as to how much) can be exerted over foreign government investors through diplomatic channels.

G. Political Objectives. A foreign investor (expecially if government controlled) may use his influence over a US firm to advance political objectives of the parent nation.

Danger	Existing Protection
1. The firm would disseminate propaganda advocating the objectives of the parent nation.	1. The Foreign Propaganda Dissemination Act would require the firm to file an extensive registration statement with the Attorney General and clearly indicate that any propaganda disseminated was sent on behalf of a foreign government.
2. The firm would attempt to influence the U.S. political processes	2. The Federal Election Campaign Act Amendments of 1974 apply to all contributors in Federal political campaigns. Contributions by any individual may not aggregate more than $25,000 in any one year.

Danger	Existing Protection
3. The firm might refuse to purchase from or sell to nations unsympathetic to the objectives of the investors parent nation.	3. The antitrust laws provide protection if the boycott or refusal to deal constitutes a restraint of trade.
4. Acquire a US arms producer and require it to manufacture arms abroad in the parent nation.	4. There are various controls on the export of essential classified technology related to arms manufacture. And USG facility clearance will not be granted to contractor activities outside the US.

<u>H. Government Investor.</u> A foreign government might use its status as a sovereign to avoid some of the ordinary incidents of investment like taxation or lawsuits.

<u>Danger</u>	<u>Existing Protection</u>
1. The doctrine of sovereign immunity would prevent lawsuits against foreign governments.	1. The US adheres to the doctrine of sovereign immunity which means that a foreign government would <u>not</u> be immune from suit when engaged in commercial activites in the US. There are, however, problems with execution on a foreign sovereign's assets to satisfy a judgment. Foreign governments engaging in international investment can be required to waive defense of sovereign immunity as a condition precedent to the investment.
2. Foreign governments engaging in direct investment in the US might use tax exemptions as a way to gain a competitive advantage over US firms in the same market.	2. While foreign governments are generally exempt from taxes on investment in the US, the exemption does not apply to the income of a separate profit making corporation which is owned by a foreign government.

V. Possible Restrictions and Other Actions Regarding Foreign Investment

A. Proposals in the 93rd Congress

The bills introduced during the 93rd Congress give an indication of the approaches toward foreign investment that might be taken in the current Congress.

(1) Percentage Limitations. Certain proposals would establish a maximum percentage limit on foreign ownership of any U.S. enterprise. Variations on this approach include different limits for equity participation and debt participation; limits only for foreign participation in selected U.S. industries (as specified in the legislation or administratively) which (a) have access to data concerning national security or (b) produce basic materials (e.g. energy, steel, etc.).

(2) Reporting. Other proposals would require U.S. firms to identify existing foreign ownership interests. Such legislation would confer upon a single agency ongoing responsibility to collect data on OPEC investment as it affects the United States. Some proposals would require foreign investors themselves to report their acquisitions to the United States Government.

(3) Prior Notice. All foreign investors desiring to purchase an interest in a publicly held U.S. firm would be required to register in advance of their purchase with the SEC. Also, prior United States Government approval of broker, dealer or bank transactions in the securities of certain industries would be required to assure that foreign investors are not acquiring these securities. These measures,which were tied to other investment restrictions, would presumably insure adequate information concerning the scope of foreign investment and permit the United States Government to act in advance to block acquisitions found to be undesirable.

(4) General Restraints on Doing Business. United States controls would be extended over foreign firms doing business in the United States through branches, divisions or subsidiaries.

B. Proposals in the 94th Congress

Only a few bills relating to foreign investment in the United States have been introduced so far.

(1) Reporting

(a) Senator Hugh Scott has introduced a bill (S.329) which would require any foreign investor or his agent who accumulates an interest in a U.S. business worth more than $10,000 or which exceeds more than 0.5 percent of its securities, to submit reports to the Commerce Department on a quarterly basis.

(b) Senator Harrison Williams has sponsored legislation (S.425) with a number of far-reaching provisions.

-- It would require the disclosure of the beneficial ownership of more than 5 percent of the securities of all publicly traded corporations. This would be accomplished by an amendment to the SEC's 13(d) statement to elicit information as to the owner's residence and nationality and identical data concerning any person who possesses sole or shared voting authority over the securities.

-- The tender offer provisions of the Williams Act would be amended to require that foreign investors file a 13(d), statement with the SEC 30 days in advance of any acquisition of 5 percent or more of the equity securities of a U.S. company. The statement would be confidential.

-- This statement would be transmitted by the SEC to the President, who could review the proposed transaction and prohibit it during the 30-day period. The criteria for this decision-making process include adverse effects on the U.S. domestic economy, foreign policy, or national security.

-- The SEC, the Attorney General, or any U.S. corporation in which a foreign investor had acquired an interest or any shareholder of such a corporation would be authorized to sue in federal court to unwind any acquisition made in violation of the pre-notification requirements. Among other powers the court would be specifically authorized to freeze voting rights of shares or to compel their disposition. In the event of disobedience of any order, the court could vest ownership of the securities in a trustee who could then sell them.

-- Issuers of reigstered securities would be required to maintain and file with the SEC a list of the names and nationalities of the beneficial owners of their equity securities.

(2) Restrictions

(a) Representatives Fish and Roe have introduced identical bills to restrict foreign investment in the United States (HR 411 and HR 945) and to creat a Joint Congressional Committee on Foreign Investment Control in the United States (HR 418 and HR 954).

-- The National Foreign Investment Control Commission would limit and restrict (and possibly require divestiture of) foreign investment in certain corporations and natural resources deemed essential to our national security and/or economic security.

-- The Joint Congressional Committee would oversee the operations of the Commission and make recommendations to both houses of Congress or the Commission concerning matters under its jurisdiction.

(b) Representative Stark has sponsored a bill (HR 2052) to amend the Bank Holding Company Act of 1956 to prevent aliens from owning more than one U.S. bank. Currently, foreign investors using personal funds instead of corporate money are exempt from the Act.

C

6

General Benefits and Costs of Foreign Investment in the United States

February 7, 1975

Introduction

At the macroeconomic level the principal benefit to the United States of minimizing the restrictions against the inflow of foreign investments[1/] is the resulting general increase in the resources available to the domestic economy. These resources became available through the functioning of an increasingly interdependent world economy in which flows of capital are directed by market forces to their most productive uses, and the U.S. as well as all other countries benefits from a more efficient allocation of capital and other resources. Thus, the basic case for freedom of capital flows among countries, including foreign investment flows into the United States, is the same as the basic case for a free enterprise economy and an open world economy. There is the general presumption that average self-interest motivated market behavior will lead to socially desirable outcomes and an efficient allocation of resources. Government intervention is called for only in cases where there is a strong presumption that the market outcome would be socially undesirable.

In examining the macroeconomic effects of foreign investment, it is important to keep in mind that the greater resource availability brought about by net foreign investment in a given year carries with it the necessity of increased foreign payments in future years. Thus capital inflows will affect the pattern of current account deficits and surplus not only in the initial year of the inflow but also over the life time of the investments until they are liquidated. Under our present regime of generally flexible exchange rates, however, it would not be desirable for the government to attempt to regulate capital flows with the objective of achieving some target time path of current account surplus and deficits.

1/ The term "foreign investment" usually refers to foreign acquisitions or holdings of U.S. assets in the form of plant and equipment, stocks, bonds and other long-term investments as opposed to short-term liquid holdings such as bank deposits. It should be noted, however, that all foreign claims on the United States, in whatever form, constitute foreign investment and there is no *a priori* basis for differentiating between the various kinds of foreign investment as regards their economic effects. In fact, a large part of what is commonly identified as "foreign investment" or as "inflows of foreign capital" is merely a change in the form of foreign claims on the United States. When a foreigner purchases long-term assets in the United States, the purchase is usually financed by drawing on dollars held in bank accounts in the United States. Thus in such cases an increase in foreign long-term claims on the United States (a "capital inflow") is offset by a decrease in foreign short-term claims on the United States (a "capital outflow") and there is no net effect on the international investment position of the United States.

The fact that the return of foreign-source capital accrues to foreigners rather than to U.S. persons does not mean that U.S. national income is less than in the case of investments from U.S.-source capital. Thus the outflow of dividend and interest payments to foreign investors is matched by an equivalent or greater increase in national income as a result of the foreign capital. This general economic presumption is reinforced by consideration of domestic tax effects. For example, if an increment of capital earns an economic return of 20 percent and it is taxed by the U.S. Government at a rate of 50 percent then the cost to the United States of foreign-source capital is 10 percent while the gain to U.S. output is 20 percent.

Competition

An important general benefit to the U.S. economy from foreign investment is that of increased competition which can cause new innovation by American firms, lower consumer prices, and increases in the quality of products.

Investment in a new facility would seem to be more likely to provide a stimulus to competition than a takeover of an existing firm. Yet takeovers do not necessarily represent "passive" investments. The investing entity presumably enters to make a profit and often will bring different management techniques, patterns of behavior, and perhaps technology with it. These alone may be sufficient to spur competition with its attendent benefits. The danger that the opposite will occur, i.e. a reduction in competition, can be handled adequately by antitrust enforcement methods, a subject discussed in more detail in the paper on specific dangers.

Capital Formation

By providing greater access to resources, foreign investment can have an important beneficial effect on capital formation in the United States, an issue of particular importance at this time. There is general agreement that future capital requirements of the United States are massive and concern whether actual capital formation will be at the levels needed for sustained, non-inflationary growth.

Clearly, the main solutions to these problems lie in the area of controlling inflation, improving incentives to save and invest, and encouraging economic growth through macroeconomic policies and regulatory reform. Yet many corporations, bankers and financiers see the potential of substantial investments of oil producer funds in the United States private sector as an important new source of capital funds which will make it easier for the United States to finance its capital requirements in the private sector and presumably will result in an increase in capital formation over what otherwise would occur. Others, mainly economists, have argued that because capital is fungible and domestic and international capital markets are relatively efficient, it is difficult to show that substantial foreign long term investments in the private sector of the U.S. economy will result in a significant increase in productive assets in the private sector over what would occur if these funds were invested elsewhere in the integrated capital markets, say in Treasury bills or Eurodollar deposits.

Foreign investment would increase the stock of productive assets in the United States in the private sector if:

(1) in the case of direct investments, foreign investors undertook projects domestic investors would not have undertaken; or

(2) foreign investment reduced the cost of capital to U.S. companies.

In the first case, foreign investors would have to have some special ability not possessed by domestic investors or different objectives. Several significant existing foreign direct investments in this country probably fall in this category. OPEC investments in the United States are not likely, at least for some time, to be in areas where they have some special ability or technology. But it does seem likely that oil producers will in certain cases have different objectives from domestic investors. Probably the number of sizable grass-roots investments by oil producers will remain small. But they have shown a particular interest already in real estate development and agribusiness, and certain downstream oil industry investments might be more attractive to producing countries than to domestic investors.

The second case, the potential effect on the cost of capital to U.S. companies, is the more important consideration. This case concerns the purchase by foreigners of new or outstanding issues of corporate stocks or bonds or direct financial participation in U.S. companies. In the sense of GNP accounting, these transactions themselves are not investments; they are merely shifts of ownership of existing wealth from one person to another; they are not directly income producing although they presumably increase utility, and they are not counted in GNP. These transactions occur in a free market and thus presumably do result in an increase in utility or net benefits to those that participate in the transactions. Yet such financial transfers, although not immediately associated with income creation, would indirectly affect business investment if they resulted in a reduction in the cost of capital funds.

If we assume that OPEC investors will desire to place a significant amount of their funds directly into long term investments in the private sector of the U.S. economy, we still must consider the likely net effect of these investments on capital formation. The United States, of course, will import real resources only to the extent of a current account deficit. We know that an inflow of funds in a given market does not mean that supply in that market increases by the full amount. Well functioning capital markets work to even up the supply of capital to the various markets until rates of return, adjusted for risk and liquidity, are equal throughout the economy.

In the case of producer country investments in the U.S. corporate sector, it seems likely that the market adjustments would not be completely offsetting, and some reduction in the corporate cost of capital would result. The net increase in capital formation in this sector, however, would be significantly less than the gross inflow of foreign funds. Sizable producer investments in the stock market could induce additional domestic purchases by improving the business investment climate generally, and in particular, in the equity markets. Such an improvement might eventually prove transitional, but the transition period could be quite lengthy. Yet, some domestic investors may view the surge in stock prices as quite temporary and not justified by expected future profits. These investors would presumably withdraw from the equity market and invest their funds where the expected return is greater.

Another consideration is the likely change in asset preferences of investors that will result from the transfer of ownership of investable funds to the producers. The present yields on financial assets domestically and internationally reflect the asset preferences of existing investors and institutions. It is believed that some OPEC investors may well see investments in U.S. corporate securities (debt and equity) in a more favorable light than the existing set of investors. These new investors are governments, or government-directed, and they are considering not only the expected profitability of such investments from the viewpoint of portfolio investors but also such factors as prestige, the possible benefits to domestic development programs (e.g. technology transfers), or other national interests (e.g. defense requirements).

If indeed investor preferences shift towards U.S. corporate liabilities, one would expect a shift in yields, reducing yields on corporate securities and raising yields on other assets, at least relatively. This would lead to increased capital formation in the corporate sector and (unless there is a general increase in saving and a general reduction in the cost of capital due to the oil price increases) a reduction in capital formation in sectors where the cost of capital has increased. Such yield shifts based on a change in the set of investors in the United States might well be permanent.

However, the size of the yield shifts due to oil producer investments is not likely to be very great. Despite the large total amount of investable funds at their disposal, it does not appear that the volume of funds they are likely to place in the U.S. corporate sector will be large in comparison to the total size of our corporate equity and debt markets.

Finally it must be noted that while <u>direct</u> placement of OPEC funds into the corporate sector would have the most immediate effect on the availability of capital in the corporate sector, any <u>net</u> inflow of foreign capital into the United States, even if into Treasury bills, would increase the total amount of capital resources available to U.S. borrowers, including the corporate sector, and presumably reduce the cost of capital.

In summary, the role of a particular segment of the spectrum of investors in our capital markets in determining the rate of capital formation is rather uncertain. What does appear clear is that imposition of restrictions on the ways a group of investors are allowed to invest their funds interferes with the allocation mechanism of the private markets. The alternative for the private market allocation mechanism is some official determination of where funds should go. This alternative is likely to result in considerably less than an optimal allocation of capital and probably would tend to have a negative effect on capital formation.

General Dangers or Costs of Foreign Investments

Turning to the dangers or negative aspects of foreign investments in the United States, there are only two issues which seem to fall in the general or macro category. The first of these is the arguments heard in many countries that foreign investment can adversely affect the national character, deter domestic entrepreneurship and give to foreign interest undesirable economic and political power over the domestic economy. Such fears may have substance in a small country, but have less relevance at the national level to a country as large as the United States where even a large amount of foreign investment will be a relatively smaller share of the total economy. Moreover, as U.S. investors have found abroad, even when foreign investors play a major economic role in a smaller economy, the sovereign powers of the host government are still pervasive and the actual powers of the foreign investor are considerably less than what consideration of only their economic importance to the country might suggest.

Under reasonable assumptions relating to their distribution of funds, OPEC's investments should amount to between 1.5 and 5.0 percent of the value of securities in U.S. financial markets. Even under the most extreme assumptions, OPEC holdings would remain a small fraction of the value of U.S. financial securities and hence need not exert a pervasive influence on the national character and operation of the American economy. (For a detailed explanation of these estimates, see OASIA Research paper, "OPEC Accumulations as a Proportion of Financial Markets in 1980.")

A second general concern is that of access to U.S. technology. This is, of course, a two way street; and in the past the U.S. has benefitted from the introduction of new technology by foreign investors, for example, in the pharmaceutical industry. Yet, the present concern is mainly with respect to OPEC country investors who have little to offer the U.S. in the technology area. Will increased foreign investments from the OPEC nations lead to the transfer of commercially valuable technology abroad, where such transfer would not otherwise have taken place? The development strategies of at least some of the OPEC countries involve rapid industrialization, with an apparent emphasis on advanced technology. Given the very large revenues they earn, such countries might offer above-market prices to acquire particular technologies, in effect moving entire firms from the United States to, say, Iran. The "loss" to the United States in such cases at worst would be no greater than if such a transfer were carried out by a U.S. firm. It would likely be less unfavorable, for two reasons.

-- the over-the-market payment would yield a monopoly rent to U.S. shareholders.

-- the rather primitive state of the economies of the OPEC member makes it highly unlikely that advanced industries located in these countries would be able to mount effective competition to U.S. products for many years to come.

Thus, it appears that premature transfer -- i.e., transfer before market forces would cause it to occur -- would be quite unlikely, and in any case would not be costly to the United States, especially since generally there are several competing sources of technology and product in the United States -- e.g., aircraft, computers, machine tools.

If there is any danger to the United States from foreigners gaining access to U.S. technology via inward direct investment, it seems much more likely to come from other industrial countries. If any policy is desirable, it should be <u>general</u>, not strictly with respect to OPEC. As with flows of goods and capital, economic theory indicates a strong presumption in favor of a policy of neutrality -- i.e., allowing market forces to determine flows of all these types, except in such exceptional circumstances as national defense considerations.

D

~~CONFIDENTIAL~~

February 18, 1975

Probable Foreign Reaction to New U.S. Restraints
and
Possible Impact of Restraints on International Negotiations

Foreign reactions to a modification of our inward investment policy will vary according to the magnitude of the change and its effects on particular countries. This paper assesses the probable reactions and the impact on international negotiations if the U.S. Government were to impose (1) a mandatory registration and disclosure requirement and/or (2) screening or added specific restrictions. Once the range of specific policy options has been developed, the State Department will query our missions concerning possible foreign reaction.

I. Mandatory Registration and Public Disclosure

A registration requirement would centralize and extend somewhat the present reporting requirements of SEC, Commerce, Treasury, and other government agencies. The information obtained through registration could be made available to the public. Substantial penalties would be imposed for non-compliance. The requirement would not discriminate as between foreign investors and, by itself, would not violate our FCN obligations.

The nature of the foreign reaction will depend on whether such a requirement is ex-ante or ex-post and on whether it is interpreted as signaling a major change in U.S. inward investment policy.

OPEC Reaction:

Given the concern of most OPEC investors for anonymity and security, even a simple registration requirement could have a negative impact on our relations with OPEC countries, especially if registration were interpreted as representing a fundamental shift in the climate for OPEC investment in the United States. Possible negative reactions which have been mentioned include:

- -- general deterioration of U.S.-oil producer relations, including discontinuation of Joint Commissions;
- -- diminished OPEC investment in the United States;
- -- further OPEC oil production cutbacks;

DECLASSIFIED
AUTHORITY Treasury ltr. 8/22/06; state guidelines
BY [initials] NARA, DATE 9/10/09

~~CONFIDENTIAL~~

-- continued resistance to any reduction in oil price levels;
-- intransigence in other negotiations including Arab/Israeli questions (by Muslim OPEC members) and the Secretary's "New Dialogue" with Latin America (by Ecuador and Venezuela).

Most other major developed countries (and OPEC countries) already require registration of foreign direct investment. Many have additional, more stringent restrictions (see the first appendix for details). The degree of enforcement varies widely and over time. Thus, even with registration, the United States would remain one of the least restrictive sites for OPEC investment. Careful prior consultations on a non-discriminatory reporting requirement could minimize adverse reaction by the oil producers. It therefore seems unlikely that a registration requirement identified as an attempt to meet a legitimate need for information without fundamentally altering our policy of neutrality on inward investment would result in significant deterioration in U.S.-oil producer investment relations.

OECD Reaction:

Since most OECD countries already have registration requirements, U.S. adoption of such a policy should not be a major source of concern for them. Still, a public disclosure provision might elicit complaints from individual foreign investors, especially if it were not applied equally to U.S. investors as well. Also, any attempt to employ the registration requirement to determine beneficial ownership would come into conflict with certain bank and commercial secrecy laws.

Prior consultations with our OECD partners about such a requirement would help to reduce any adverse reactions and would advance our objective of promoting regular multilateral consultations within the OECD on government investment policies.

LDC Reaction:

Apart from OPEC members, developing countries have negligible investments in the United States. Therefore, a registration and disclosure requirement would probably not have a significant impact on our relations with the LDCs.

II. Screening or Added Restrictions

The next step beyond an ex-post registration requirement would be an increase in ex-ante restraints such as screening or new specific sectoral limitations. Such measures would have a greater foreign relations impact than registration. It would be difficult to predict what, if any, differing foreign reaction would result from screening as opposed to new specific limitations. It would seem reasonable to postulate, however, that any new restraints affecting inward investment "across the board" would have a greater impact than screening or new limitations in a few sensitive sectors.

Stand-by authority for screening or new restrictions could produce a more negative reaction than restraints which were immediately operational. Stand-by authority would increase foreign investor uncertainty, and thereby add to our uncertainty as to their intentions. Stand-by authority could also involve our inward investment policy more directly in U.S. domestic affairs since xenophobic groups and existing corporate managements seeking to protect their vested interests could be expected to agitate to have the stand-by authority invoked. Such action could increase the possibility of a proposed investment becoming an irritant in our relations with another country, especially as a global screening procedure would violate numerous of our FCN treaties.

OPEC Reaction:

The desire of the OPEC nations for developing their industries and national defense production infrastructure and technology has already led some of them to seek investments in sensitive industries of developed country economies. While economic motives undoubtedly play an important part in these investment and loan activities, security and political considerations are also present.

New sectoral restrictions or screening are likely to prevent OPEC states from making some investments which they otherwise would. If the investment restrictions were limited to a relatively few sensitive sectors, the OPEC reaction might be reduced. Even with some new sectoral restrictions, the United States and West Germany are likely to provide the OPEC countries with their most attractive investment opportunities. It should be noted that many of the complaints which have been heard from OPEC investors concern the present uncertainty about the future course of U.S. inward investment policy. In this regard, it might be well for us to heed our own advice to the LDCs: Stability of the rules of the game is extremely important to any investor.

The risk of decreased OPEC investment and of oil production cutbacks increases with the extent of any new restrictions. Restrictions which were directed specifically against OPEC countries would almost certainly stimulate retaliation. The harsh criticism of Ecuador and Venezuela to the anti-cartel provisions of the Trade Act are indicative of the sensitivity of these OPEC members to discriminatory treatment. A veiled attempt to get at the OPEC nations by restricting "government" investment might carry a similar risk and would certainly encourage evasion efforts.

Most of the OPEC countries with financial surpluses are newcomers to the ranks of major foreign investors. Consequently, their inward investment policies have been predominantly determined by domestic or regional political considerations. As OPEC foreign investments increase, however, the treatment of these investments will probably become more of a factor in shaping their inward investment policies. In such circumstances, new U.S. ex-ante investment restraints could well discourage the OPEC countries from liberalizing their own extensive restrictions or lead to the imposition of additional restrictions. It seems debatable whether that OPEC nations would take extreme retaliatory action (such as nationalization) against American firms solely on the basis of moderate and nondiscriminatory new U.S. inward investment restrictions. New U.S. restrictions which blocked specific projected OPEC investments would increase the likelihood of adverse reaction by oil producer governments.

Prior consultations with the OPEC nations on changes in our inward investment policy would help to moderate the negative impact of a more toward a more restrictive inward investment policy.

OECD Reaction:

The United States maintains one of the most liberal inward investment policies of any major industrialized country. Canada and Australia both have explicit across-the-board screening mechanisms and de facto screening takes place in many other OECD countries, including the U.K., France and Japan. The less developed members of

OECD all maintain numerous restrictions on inward investment. Moderate new U.S. restrictions in sensitive sectors therefore should not result in retaliation by other OECD members against U.S. investments although they could discourage some OECD investments here. New U.S. restrictions, even if relatively modest, might well become an intergovernmental issue if they had the effect of blocking specific investments being contemplated by firms in other OECD countries. Broad new restrictions which violated our FCN treaty obligations would elicit protests and invite retaliation against our investments. (See appendix 2 for a discussion of FCN Treaties.) A more restrictive U.S. inward investment policy could have a negative effect on our ability to lead efforts in the current OECD investment exercise to maintain liberal policies toward foreign investment. A more restrictive U.S. policy could also lend greater respectability to the more extreme restrictions imposed by other countries and would strengthen the hands of those such as Canada and Australia who are not anxious for any new OECD action in the field of government investment policies. New U.S. derogations to the OECD Capital Movements Code would encourage others to weaken their own commitments. Prior consultation in the OECD aimed at coordinating OECD policies would somewhat lessen the adverse reaction to a more restrictive policy.

The OECD countries are unlikely to favor a U.S. policy which discriminates against the OPEC nations. No OECD countries currently maintain policies which explicitly discriminate against foreign investors by nationality, apart from limited reciprocal preferential treatment among EC member countries. The Europeans and Japan would oppose measures which would increase the possibility of confrontation with the oil exporters and have tended to favor measures, such as the IMF recycling plan, which would strengthen the role of OPEC nations in the world financial system. In addition, there would be concern that discrimination against OPEC investment today might be extended to them tomorrow. The Japanese surely recall that in 1973 it was their investment -- not those of Arab oil producers -- which produced the public outcry in the United States.

On the other hand, the British and German governments are currently reviewing their inward investment policies, reportedly in response to public reaction in their countries to some highly publicized transactions involving OPEC investors. Preliminary reports indicate that they are considering

LIMITED OFFICIAL USE

POLICIES AND PRACTICES OF MAJOR DEVELOPED COUNTRIES RELATING TO INWARD DIRECT INVESTMENT (Particularly from OPEC Countries)

In general, the policies and practices of major developed countries relating to inward investment which are summarized below represent their traditional views on this subject and do not stem directly from the recent concerns with OPEC investment (although the implementation of existing policies may in some cases have been adjusted to take such concerns into account). One explanation for the current inactivity is the fact that, for most countries other than the United States, the question of sizeable inward investments in critical industries is one which has been confronted--and resolved--before when faced with U.S. investments. While OPEC investments may have certain special qualtities (for example, the fact that most involve takeovers of existing enterprises rather than creation of new ones), many countries already have safeguards which they consider adequate to protect their economies.

A second reason is that many of the smaller countries do not expect to have large amounts of petrodollars invested in their economies. It may well be that most of these would react negatively should extensive investments materialize, especially if they were concentrated in vital economic sectors. Such a reaction might be influenced heavily by the attitudes towards OPEC investments expressed by the OECD members, particularly the United States and the FRG, which have traditionally pledged support for the principle of freedom of international capital movements as embodied in the OECD Code of Liberalization of Capital Movements (of which all OECD members except Canada are adherents).

The following notes relate to the summary of country policies and practices below:

-- Screening involves discretionary power by the national government in approving or disapproving individual investments, as opposed to outright restrictions.

-- Except where otherwise noted, countries have taken no overt steps designed to control OPEC investments in particular, either in policy or in practice.

-- The statement "foreign direct investment generally welcome" does not necessarily exclude restrictions on investment in specific vital sectors comparable to those currently imposed in the United States with respect to atomic energy, air transport, coastal shipping, etc.

Australia:

(1) Screening of all foreign direct investments.

(2) Policy is aimed at maximizing Australian ownership and control of local resource industries.

Belgium:

(1) Foreign direct investment generally welcome.

Canada:

(1) Screening of foreign takeovers of domestic corporations (prospectively of new investments).

Denmark:

(1) Foreign direct investment generally welcome.

(2) Indications that balance of payments concerns are leading Danes to seek petrodollars loans and investments.

France:

(1) Screening of all foreign direct investments.

(2) Indication that OPEC or other foreign takeovers of heavy industry, such as Iranian purchase of interest in Krupp, would not be permitted.

Germany:

(1) Foreign direct investment generally welcome, with an *ex post* reporting requirement. (Following the unexpected Kuwait investment in Daimler-Benz, Chancellor Helmut Schmidt reportedly now favors legislation to require *ex ante* disclosure of the names of foreigners undertaking direct investment in German companies.)

Italy:

(1) Foreign direct investment generally welcome.

(2) Balance of payments concerns are leading the Italians to actively encourage petrodollar recycling in Italy.

Japan:

(1) Screening of all foreign direct investments.

Netherlands:

(1) Foreign direct investment generally welcome.

Switzerland:

(1) Foreign direct investment generally welcome.

(2) Indications that foreign takeovers of Swiss firms would be opposed.

United Kingdom:

(1) Screening of all foreign direct investments.

(2) Labour Government may move toward increasing general restrictions on foreign direct investments of any origin.

APPENDIX 2

Treaties of Friendship, Commerce and Navigation

The traditional friendship, commerce and navigation treaty (FCN) is designed to establish an agreed framework within which mutually beneficial economic relations between two countries can take place. The executive branch has long regarded these treaties as an important element in promoting our national interest and building a strong world economy.

To our benefit, the treaties establish a comprehensive basis for the protection of American commerce and citizens and their business and other interests abroad, including the right to prompt, adequate and effective compensation in the event of nationalization. However, the FCN treaties are not one-sided. Rights assured to Americans in foreign countries are also assured in equivalent measure to foreigners in this country.

From the viewpoint of economic foreign policy a measure of incentive for the FCNs was the desire to establish agreed legal conditions favorable to private investment. The heart of "modern" (i.e. post World War II) FCN treaties (and those with our OECD partners are generally of this type) is the provision relating to the establishment and operation of companies.

This provision may be divided into two parts: (1) the right to establish and acquire majority interests in enterprises in the territory of the other party is governed by the "national treatment" standard. (National treatment is defined in the treaties as "treatment accorded within the territories of a contracting party upon terms no less favorable than the treatment accorded therein, in like situations, to nations, companies, products, vessels or other objects, as the case may be, of such party.") There are no FCN treaties with OPEC countries which contain this provision. Secondly, the "controlled" domestic company is itself assured national treatment and discrimination against it in any way by reason of its domination by alien interests is not permissible. Our FCN treaty with Iran has this provision. Our 1933 provisional agreement with Saudi Arabia can be interpreted to provide similar protection.

The FCN treaties do exempt certain areas from the "national treatment" standard in order to conform with laws and/or policies in existence when the treaties were negotiated and in order not to infringe upon other treaty obligations of the

United States or our national security interests. Thus, specific exclusions from national treatment are provided in the areas of communications, air and water transport, banking, and exploitation of natural resources. Also, the modern FCN provides that it does not preclude the application of measures regarding fissionable materials, the manufacture of implements of war, traffic and materials carried on directly or indirectly for the purpose of supplying military establishments or necessary to protect essential security interests.

E

GERALD R. FORD LIBRARY

This form marks the file location of item number 1d as listed on the pink form (GSA Form 7122, Withdrawal Sheet) at the front of the folder.

LIMITED OFFICIAL USE

OPEC Accumulations as a Proportion of
Financial Markets in 1980

Recent estimates of peak OPEC accumulations lie in the range of $200 to $300 billion in 1974 dollars, with the peak occurring around 1980. In the following comparisons $250 million is used as a round order of magnitude.

These accumulations, though massive in absolute magnitude, need to be compared with other magnitudes if their economic significance is to be evaluated. Value of assets in major world financial markets where these funds will be held is perhaps the most relevant single comparison.

The value of equities, bonds, and short-term debt in OECD and major international capital markets totalled nearly $3 trillion in 1972 (in 1972 dollars; in 1974 dollars this figure might be on the order of $3 1/2 trillion). The U.S. accounted for roughly 3/4, or $2.2 trillion, of the 1972 total.

Assuming 10% annual market growth in nominal terms by 1974, total value of assets in these major world financial markets would be nearly $3.6 trillion in 1974 dollars; the U.S. share might be on the order of $2.7 trillion if the 75% U.S. share holds up. (This compares closely with a McGraw-Hill estimate of total U.S. debt -- public and private -- of $2.5 trillion in 1974.)

A continued nominal growth of 10% per year, with inflation rates of 12% through 1976 and 7% thereafter (the same inflation rates assumed in deflating the 1980 OPEC accumulations) yields an estimated capital market size of $3.8 trillion (constant 1974 dollars) in 1980. Since U.S. new issues are a relatively smaller percentage of total new issues (37% in 1972) than of outstandings, the U.S. share would be reduced to perhaps 70% or $2.7 trillion.

If OPEC financial accumulations total $250 billion (in 1974 dollars) in 1980, they would amount to less than 7 percent of the total value of outstanding assets in the major national and international financial markets. Even if we allow for a 25% overestimate of capital market size in 1980, the accumulations would be less than 9% of this smaller total (i.e., of $2.85 trillion).[1/]

For the U.S., the relative size of OPEC holdings would almost certainly be considerably smaller. For example, if OPEC invested 20 percent (the current proportion) of its total 1980 accumulations in the U.S., this would amount to 1.5 to 2.0 percent of U.S. financial assets. If OPEC invests as much as 40 percent, or $100 billion, OPEC investments in the U.S. would still be only 3.6 percent of the value of U.S.

1/ Such a comparison implies an actual shrinkage in real terms of world capital markets between now and 1980.

financial markets on the above assumption. Even with no real growth in U.S. financial markets between now and 1980, OPEC investments of $100 billion (in 1974 dollars) would amount to less than 5 percent of total U.S. financial assets. In the most extreme case -- total OPEC accumulation of $250 billion in a U.S. capital market which has shown no growth between now and 1980 -- OPEC investment would still amount to no more than 10 percent of total value of U.S. financial markets.

The foregoing discussion suggests that appropriate U.S. policy toward inward investment should not be strongly affected by the magnitude of OPEC dollar holdings. Even under the most extreme assumptions, OPEC holdings would still be a relatively small fraction of the size of U.S. financial markets and hence need not exert a pervasive influence on the national character or operation of the U.S. economy.

OASIA/Research
February 14, 1975

F

Extract from minutes of CIEP Executive Committee
Meeting of December 21, 1973

V. International Investment

A. Foreign Investment in the U.S.

Mr. Flanigan noted that a number of hearings had been scheduled by various Congressional committees on foreign investment in the U.S. and that a CIEP working group had developed an outline of a suggested approach for Administration witnesses for approval by the Committee. Mr. Niehuss reported that three bills relating to foreign investment in the U.S. had already been introduced and that hearings were scheduled or contemplated by four different committees early next year. He noted that the CIEP interagency working group had suggested that Administration witnesses state that U.S. policy was to (a) continue to freely admit foreign investment into the U.S. and to treat foreign investors on the basis of equality with domestic investors once they were operating in the U.S.; (b) work towards the development of a better data base with respect to foreign investment in the U.S.; and (c) review existing restrictions on foreign investment in the U.S. to see if they were still needed. There was no discussion or objection and it was agreed to accept the working group's suggested policy for Administration witnesses.

GUIDANCE FOR ADMINISTRATION WITNESSES WHO TESTIFY CONCERNING FOREIGN DIRECT INVESTMENT IN THE U.S.

Background

Although foreign direct investment in the U.S. (hereinafter referred to as "FDI") rose from $7.6 billion to $14.4 billion in the decade from 1962 to 1972, there were wide fluctuations in the yearly growth. It varied from a low of $257 million in 1966 to a high of $1,452 million in 1970, which was followed by a sharp drop to $385 in 1971 and a subsequent rise in 1972 to $708. It is certain that 1973 FDI will show a substantial increase over 1972; FDI for the first six months of 1973 was $728 million, and projections for the entire year range from $1 to $1.5 billion (See Tab 1 for Statistical Summary).

The 1973 growth has been accompanied by widespread publicity given to such developments as the Canada Development Corporation tender offer to Texasgulf and Japanese investment in Hawaii and California. In addition, the devaluation of the dollar, the uncertainty as to future U.S. trade policy, the growing size and sophistication of foreign firms and the depressed state of our stock market have created fears of even larger increases in 1974.

As a result, a number of Congressmen have introduced (or begun drafting) bills which would restrict FDI. For example, the Dent Bill would prevent non-U.S. citizens from owning more than 5% of the voting securities of U.S. companies registered under the Securities Exchange Act of 1934. In addition, Congressman Moss is drafting a bill which would limit foreign control of companies in the energy and national defense sectors. (See Tab 2 for a Summary of Expected Congressional Activity).

Current Policy

U.S. policy with respect to international investment has been based on the premise that the operation of free market forces in determining the direction of worldwide investment flows will maximize the efficient use and allocation of capital resources in the international economy. Accordingly, our basic policy toward FDI has been to admit and treat foreign capital on a basis of equality with domestic capital. We have offered foreign investors no special incentives to attract them to the U.S. and, with a few internationally recognized exceptions, have imposed no special barriers to FDI. In other words, our policy has been to freely admit foreign investors and to treat them on the basis of equality with domestic investors once they are operating within the U.S. Such a policy has been consistent with our overall dedication to the freest possible trade, nondiscrimination against foreigners, and encouragement of competition from all sources. It is also consistent with our obligations under the OECD Capital Movements Code and is reflected in bilateral treaties of Friendship, Commerce and Navigation with most of our major trading partners.

We have, however, imposed some restrictions on FDI in certain sensitive sectors of the economy which have a fiduciary character, relate to the national defense or involve the exploitation of certain natural resources. The most important sectors affected are coastwise and freshwater shipping, domestic radio communications, domestic air transport, acquisition or exploitation of federal mineral lands and hydroelectric power. These restrictions are generally accepted internationally as appropriate exceptions to national treatment and are incorporated into most of our bilateral treaties. Additionally, restrictions on foreign investment, particularly in banking, insurance and land ownership are imposed by many states. A CIEP working group is reviewing state restrictions and incentives along with the general question of state powers to regulate FDI. (See Tab 3 for a summary of the current restrictions on FDI)

Frame of Reference

Any policy with respect to FDI should be consistent with the President's view that:

> "an open system for international investment, one which eliminates artificial incentives or impediments here and abroad, offers great promise for improved prosperity throughout the world" (April 10, 1973 Message concerning the Trade Bill).

In addition, U.S. policy with respect to FDI should be made in the context of the Administration's overall efforts to contribute to the productive reform of the international economic system. As Secretary Shultz noted recently:

> "International monetary reform, international trade and investment, and improving the quantity and quality of international development assistance are all aspects of the same problem of constructing an endurable system of economic intercourse. Because they are inextricably linked, because we must negotiate in all these fields with the same countries and frequently with the same individuals, what the United States does or does not do in regard to (one area) will inevitably have a profound impact on what we are able to accomplish in the remaining fields". (November 14, 1973 Statement re IDA and ADB replenishment).

Because of this interrelationship, the adoption of new restrictions on, or incentives for, FDI could seriously undercut our efforts to liberalize trade and investment through international negotiations.

Suggested Approach for Administration Witnesses

No change in current policy is proposed. This means that Administration witnesses should (a) resist Congressional attempts to add restrictions to FDI and (b) state that our policy is to continue to freely admit foreign investors and to treat them on the basis of equality with domestic investors once they are operating within the U.S.

Major Reasons for the Suggested Approach

1. FDI is currently so small in relation to the size of our economy that (a) it has no significant effect on such factors as aggregate demand, employment, the money supply and the implementation of our macroeconomic policy and (b) there is no imminent or prospective threat of foreign domination or control of any significant or critical sector of our economy;

2. New restrictions (or incentives) would be contrary to the President's desire to create an "open system of international investment ... which eliminates artificial incentives or impediments here and abroad ...;"

3. Added restrictions (or incentives) would seriously undercut our efforts to liberalize international investment in multilateral forums like the OECD;

4. Restrictions would invite foreign retaliation and contribute to the growth of protectionism abroad, and new U.S. incentives might encourage competition among countries to attract investment;

5. Given the uncertainty as to the net effects of FDI on our balance of payments and its relative insignificance in our overall balance of payments flows, there is no compelling reason to restrict (or grant incentives to) FDI for balance of payments reasons;

6. Introduction of new restrictions would reduce the economic benefits from FDI (e.g. new competition and technology leading to lower prices and better products and services for U.S. consumers);

7. We already have substantial power under existing laws (e.g. antitrust laws, securities laws, and Defense Department regulations) to protect the economy from foreign control or to prevent foreign access to classified materials;

8. Granting special incentives to attract FDI would discriminate against U.S. business and subsidize its foreign competitors

9. New restrictions would conflict with international obligations which we have assumed in Treaties of Friendship, Commerce and Navigation with many of our major trading partners; and

10. Added restrictions are directly contrary to the efforts of many states to attract foreign investment.

Attachments: The following materials may be useful to Administration witnesses:

1. A brief statistical summary of FDI (Tab 1)

2. A brief summary of proposed Congressional activity with respect to FDI (Tab 3);

3. A summary of the current restrictions on FDI (Tab 2).

4. A summary of economic analysis re FDI (Tab 4).

Extract from minutes of CIEP Executive Committee
Meeting of May 22, 1974

IV. International Investment

B. Investment Policy Paper

The revised paper "U.S. Policy and Objectives on International Investment" has been approved and is attached. It will be used for internal U.S. Government guidance in the development of positions on investment issues and as an indication of future work needed on particular problems.

Attachment

U.S. POLICY AND OBJECTIVES ON INTERNATIONAL INVESTMENT

General Premises

U.S. policy with respect to international investment should aim at the following objectives:

A. Promotion of economic growth and development in the United States,

B. Promotion of political-economic relations with other nations.

We believe these objectives can best be accomplished within an international economic system providing an environment which:

i. facilitates international trade and capital flows among nations:

ii. involves a minimum of governmental interference with international economic transactions while placing maximum reliance on market forces to direct world trade and investment;

iii. evolves within a framework of international cooperation.

General Investment Objectives

In this framework, the basic U.S. policy objectives concerning investment are to achieve--to the extent possible and consistent with the nature of progress in other areas of international economic cooperation--an international investment environment in which government policies would play a neutral role, neither encouraging nor discouraging investment flows. It is recognized that the ideal of neutrality cannot be achieved short of a complete international harmonization of policies, which for the time being is an unrealistic goal. Furthermore, every nation, including the U.S. needs to preserve flexibility to act to protect its security and other vital national interests. Nevertheless, it is desirable to work toward an international system of investment behavior which will maximize the achievement of the following:

I. Investment capital should be free to move to its most productive use in response to market forces and motivations, with the minimum possible distortion resulting from national policies or practices governing or affecting investment. There should be a presumption against the use of controls on capital flows. In cases where controls are resorted to they should be subject to international consultation and surveillance. This includes controls for balance of payments or cyclical policy reasons as well as controls on entry and establishment of foreign investors for structural or for non-economic reasons. Moreover, national incentives and disincentives affecting investment of a kind which can be expected to have substantial international effects should be avoided. When considered necessary for the achievement of legitimate national objectives such policies should be amenable to international examination and discussion.

II. Foreign investors should be given national treatment, which means they should be treated no less favorably than other host-country nationals, subject to the same rights and obligations conferred or imposed by that country's laws and guaranteed full legal protection under them.

III. Foreign investors are not subjected to special, politically-motivated inducements, constraints or arbitrary treatment, and actions by governments regarding particular foreign investments are taken subject to defined rules and procedures.

IV. Adequate mechanisms are developed to facilitate international consultations on investment issues, and disputes which arise among governments are settled in accordance with international law pursuant to agreed and fair procedures.

Exceptions to these principles (including the neutrality of government policies, national security limitations, etc.), should be specifically defined, applied on an MFN basis, and recognized as subjects for intergovernmental consultation (as outlined in the following sections).

Specific Negotiating Objectives

In the complex task of reshaping the world's economic system, careful attention should be given to coordinating our efforts in the three areas of monetary reform, multilateral trade liberalization, and liberalization of foreign investment. The total implications of changes in each of these areas cannot be perceived until at least the broad outlines of the overall restructuring of the international economic system are in view. Nevertheless, it is not realistic, and hence not desirable to try to negotiate international agreements in all three areas as a single "package". Rather, where areas of consensus already exist or appear to be possible we should move ahead and attempt to obtain agreements which meet specific negotiating objectives, which are discussed in detail below.

I. Governments interfere with the operation of market flows in three basic ways:

(1) Through the imposition of exchange controls or other restrictions on capital movements for balance of payments purposes. Our objective here is to strengthen internationally-agreed guidelines or criteria governing the use of exchange controls. The appropriate forum for negotiating this objective is through the C-20 (or IMF) negotiations on international monetary reform.

As regards the negotiations over new investment rules, we seek agreement to the principles that, in the administration of exchange controls or other restrictions when imposed, governments will ensure that the controls do not operate to the competitive disadvantage of enterprises controlled by foreign investors in their business activities relative to operations of enterprises controlled by their nationals, and that disagreements over these matters between governments are a proper subject for international consultation.

We should also keep the activities of the Organization for Economic Cooperation and Development (OECD) in these matters (eg., the surveillance function of the Working Party 3 and the implementation of the OECD's Capital Movements and Invisible Transactions Codes) under review, both in terms of their adequacy and of their possible use as models for wider application.

(2) Discriminatory Measures: Through domestic legislation, policy, or administrative practice, governments may induce or prevent particular kinds of foreign investment in a manner or under criteria which differ from the laws, policies, or practices governing equivalent activities by their nationals. As a general proposition, our objective here is to secure international agreement that removes the discriminatory elements of these laws, policies, or practices, (i.e., that new investors are given national treatment) with, of course, appropriate exceptions for national security and other clearly defined, generally accepted and limited purposes.

We reocgnize that many governments currently maintain laws or procedures by which inward direct investments are screened for acceptability or are otherwise required to meet standards or criteria which do not apply to activities of nationals. Basically, we do not favor these types of controls in principle and should urge their removal. We should also resist efforts to derogate from existing commitments to avoid discriminatory measures. However, since we cannot realistically expect these countries to eliminate these laws or practices soon, it may be opportune to try to fix limits within which the existing discrimination can be contained, and to, therefore, seek agreement to the following principles by those countries which maintain discriminatory practices:

(a) Countries imposing such controls should make all limitations or qualifying criteria public and clearly defined.

(b) Once an investor satisfies these criteria and is accepted as an established investor, he shall not be required to meet new criteria not required of nationally-owned enterprises after his investment is made.

(c) If a particular investment proposal is denied, the government will state the reasons for denial and afford the investor either a reasonable amount of time to modify his proposal to meet the objections, and/or reasonable rights of appeal.

(d) There will be no discrimination among foreign investors because of their nationality. Investors from all countries will be guaranteed MFN treatment. (There would be no exception for members of a purely trading arrangement, such as a customs union or free trade area.)

(e) Disagreements over the implementation of discriminatory laws or practices should be recognized as a proper matter for international consultation.

(3) Non-Discriminatory Distortions: Through certain national policies or practices affecting investment governments distort the operation of market forces. This area includes a variety of different national laws or practices which (by design or as a side effect) may induce or discourage investment flows into or away from particular countries which economic factors alone would not do.

In many instances, these laws or practices are designed to promote valid national or international objectives. Our objective is, in general, to minimize the adverse consequences (if any) resulting from such distortions and to prevent projected or potential damage to the economy or firms of other countries.

We will, therefore, develop objectives and strategies through interagency consultations in such areas as (but not necessarily limited to):

(a) investment subsidies and other incentives which distort trade and investment patterns;

(b) tax and accounting practices affecting international investment;

(c) technology transfers connected with investment;

(d) laws designed to promote or regulate competition (anti-trust or restrictive business practice laws);

(e) information collection and exchange;

(f) extraterritorial application of national laws.

II. National Treatment for Foreign Investors

In addition to our desire for national treatment for new investors, one of our priority objectives in the investment field is to secure a workable international agreement that limits de jure discrimination and prohibits the considerable amount of de facto discrimination among foreign-controlled and national-controlled enterprises which exists in some countries. To the extent that there is discrimination in the award of public contracts, it should be most appropriately addressed in the negotiations over a new international code on government procurement. However, it also arises over such matters as access to local capital markets, pressures to invest or export, etc.

Our objectives are thus:

(1) Agreement to a firm national treatment rule (or "guidelines") for foreign investors which are established in accordance with publicly known host-country law and criteria, and that any exceptions (eg., limits on activities for national security or other specifically defined reasons, such as limits of Federal jurisdiction over states or provinces) should be clearly stated in public laws or regulations.

(2) Guarantee of full protection under, and benefits conferred by, host-country law and access to courts.

(3) Recognition that disagreements concerning national treatment of established investors are a proper matter for intergovernmental consultation and dispute resolution.

III. Protection of Investors and Governments from Political Influence

In order to insulate the activities of international investors to the extent possible from disputes arising from, or centered on, domestic or international politics, our objective is to seek agreement to the following principles:

(1) Apart from publicly known requirements or criteria which may apply uniquely to foreign investors (as discussed in I(2) and II(1) above), governments will not seek to influence or pressure foreign investors in ways which differ from policies applied to host-country nationals.

~~CONFIDENTIAL~~

(2) As regards those areas where home and host country laws create conflicting obligations on investors, we should examine within the U.S. government the possibility of negotiating agreed procedures for handling specific cases and, where possible, new general guidelines for resolving such conflicts.

(3) We are willing to explore mutually acceptable agreements defining areas in which government-to-government discussion of policies relating to investment in general or particular investments are deemed to be proper (as in those instances cited elsewhere in this paper).

(4) Governments should refrain from punitive action against private foreign investors from particular countries with whom they may have political disputes except to the extent recognized in international law.

(5) In case of expropriation or nationalization (which is recognized in international law as limited to instances which serve public purposes) host countries will afford prompt, adequate and effective compensation to foreign investors (regardless of whether such compensation is paid in the nationalization of enterprises controlled by the host-country's nationals). Disputes over compensation will be settled in accordance with agreed arbitration, conciliation or other arrangements consistent with international law (including, where appropriate, fact-finding arrangements, etc.).

IV. Consultative Mechanism and Dispute Settlement

Arrangements on investment policies should include mechanisms for consultations and the settlement of disputes. In a world-wide forum these mechanisms may be of various types. It would be desirable that they enjoy high-level leadership and participation. It is difficult at this time to define what might realistically be achieved in global negotiations on the establishment of mechanisms

~~CONFIDENTIAL~~

for consultations and the settlement of disputes. The U.S. continues to support the International Center for the Settlement of Investment Disputes, and favors adherence to this mechanism by all countries.

Within the OECD, past mechanisms for consultation and resolution of disagreements concerning government investment have lacked high-level leadership and participation. Rather than, for example, relegating consultation over investment matters among developed countries just to a technical committee of OECD, there is wide agreement on the need for a higher-level mechanism in which continuing consultation and negotiation of needed new agreements (as envisaged in I above) can take place, with policy-level guidance provided periodically and regularly.

For the present, this role of high-level consultation and guidance should be exercised by the XCSS. However, it is not now clear whether the XCSS can or should retain this function indefinitely, given its general mandate to review and guide the organization's activities in the full range of its work. Thus, as part of the OECD's continuing effort on investment reform, attention must be given to the adequacy of the existing mechanisms for consultation.

We, therefore, will propose that this issue be included on the XCSS agenda for further discussion. One of the options (in addition to that of keeping this function permanently within the XCSS mandate) should be to determine whether there may be a need for a new high-level committee (similar in concept to the EPC or WP-3) which would meet periodically with representatives from capitals. The mandate, whether exercised by the XCSS or a new committee, should be to:

(1) Review the progress of negotiations on new international agreements concerning specific investment issues (eg., investment incentives; tax matters, etc.) and give policy guidance to the work groups. (This work should be carefully coordinated with similar work in other OECD committees--eg., the Trade, Fiscal and Business Practices Committees, as well as work on related matters going forward in GATT and IMF.)

(2) Conduct consultations concerning issues which may have arisen among countries over particular problems.

Implementation

The main effort to implement the above policy objectives should take place initially among the developed OECD countries. The U.S. goal is to pursue negotiations on new arrangements and guidelines concerning investment within the OECD framework using the XCSS as the principal governing mechanism for setting the tasks and pace of the negotiations. Negotiation of new agreements or supplements to the OECD Capital Movements Code encompassing objectives I through IV above should proceed to a conclusion as rapidly as possible. Our negotiators will be guided by the fact that we wish to preserve the gains achieved through the Capital Movements Code, and that the purpose of these negotiations is largely to strengthen that Code or to enlarge its scope to the extent possible.

In negotiations in the UN (eg., in the proposed Declaration on the Economic Rights and Duties of States) or in regional activities (eg., the OAS), U.S. negotiators will be guided by the above objectives in defining the U.S. positions. The U.S. is, in principle, willing to reach agreements on one or several of these sets of principles with foreign countries so disposed on either global or regional bases. In negotiations with LDC's, it should be recognized that there may be special considerations which would necessitate acquiesing in certain non-neutral government policies with respect to foreign investment in developing countries. In such cases, care should be taken to preserve as much as possible the spirit of the principles outlined above.