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FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
1. memo	Under Secretary of the Treasury for Monetary Affairs to Ochal re: Foreign Investment Meeting 2/24/75 2. "Foreign Investment in the United States: Policy Review" ca. 2/75	2/24/75	C(A)
2a.	"Foreign Investment in the United States: Summary of Issues and Background" 7 pp.	n.d.	A
2b. Tab A	"Options for U.S. Policy on Foreign Investment in the United States" 24 pp.	2/18/75	A
2c. Tab D	"Probable Foreign Reaction to New U.S. Restraints and Possible Impact of Restraints on International Negotiations"	2/18/75	A
2d. Appendix 1	"Policies and Practices of Major Developed Countries Relating to Inward Direct Investment" 3 pp.	n.d.	C(A)
2e. Tab F	Extract from minutes of CIEP Exec. Comm. meeting of December 21, 1973 5 pp.	12/21/73	A
2f. Tab F cont.	Extract from minutes of CIEP Exec. Comm. meeting of May 22, 1974 10 pp.	5/22/74	A

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Foreign Investment

OFFICE OF THE ~~VICE~~ PRESIDENT

WASHINGTON, D.C.

re: J. Bennet call for information on

To: list ;of names on draft testimony statement this AM

From: per Pearl Burland, Secy to Mr. Bennett

Date: Time a.m. p.m.

Secy. Simon - Treas.
Robinson - State
Greenspan
Enders
Gov. Wallich , Fed. Res Bd.
Asst. Secy. Commerce Pate
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[ca. 2/75]

CONFIDENTIAL ATTACHMENT

Foreign Investment in the United States: Policy Review

JWS

Contents

CONFIDENTIAL ATTACHMENT

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A

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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. (2) the "controlled" domestic company is itself assured national treatment, and discrimination against it in any way by reason of its domination by nationals of the foreign cosignatory to the FCN Treaty . is not permissible. Our FCN treaty with Iran has such a provision. (Our 1933 Provisional Executive Agreement with Saudi Arabia might be interpreted to provide similar protection for established enterprises. However, Article V of the Agreement provides that "should the Government of the United States of America be prevented by future action of its legislature from carrying out the terms of these stipulations, the obligations thereof shall thereupon lapse". Thus, screening legislation would terminate the agreement automatically, within the terms of the agreement itself.)

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 its terms do not preclude the application of measures relating to fissionable materials, regulating the production of or traffic in implements of war, or traffic in other materials carried on directly or indirectly for the purpose of supplying a military establishment or measures necessary to protect essential security interests.

The following is a preliminary list of those countries with which we now have an FCN which calls for, or can be interpreted to call for, national treatment in the establishment and acquisition of enterprises:

Belgium
France
Federal Republic of Germany
Ireland
Israel
Italy
Japan
Korea
Luxembourg
Muscat and Oman*
Netherlands
Nicaragua
Thailand
Togolese Republic

Each of these treaties has a provision designed to prevent use of treaty rights by nationals of third countries. Thus, Article XIII of our treaty with France provides, in language similar to that in the other listed treaties,

> The High Contracting Parties may deny to any company, in the ownership or direction of which nationals of a third country or countries have directly or indirectly a controlling interest, the advantages of the present Convention, except with respect to recognition of juridical status and access to the courts.

*Muscat and Oman, not a member of OPEC, now earns approximately $900 million per year from petroleum exports. These earnings are largely used for internal development and it is not expected that the country will become a net capital exporter.

B

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 counter-action 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. Economic Interests. 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

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

Existing Protections

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

			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. Natural Resources. 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.

	Danger		Existing Protection
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 an 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.

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.

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

Danger	Existing Protection
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 not 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 constrols 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.

February 13, 1975

APPENDIX 2

LEGAL AUTHORITY FOR REGULATION OF FOREIGN INVESTMENT IN THE UNITED STATES UNDER SECTION 5(b) OF THE TRADING WITH THE ENEMY ACT (12 U.S.C. 95a, 50 U.S.C. APP. 5(b)). 1/

Section 5(b) of the Trading with the Enemy Act, which served as the statutory basis for Executive Order 11387, January 1, 1968, establishing the Foreign Direct Investment Program, could furnish a legal foundation for a program of investigation, required reporting, and regulation of investment by foreign individuals or enterprises in the United States. As will be indicated herein, using this "emergency" authority for a regulatory program of possibly indefinite duration is not without legal difficulty. It would be possible, and more appropriate, to use the statute as the basis for a temporary "bridge" program to monitor, screen, or otherwise regulate foreign investment while permanent enabling legislation were worked out with Congress.

Section 5(b) has been judicially interpreted as an expression of congressional intent to confer on the President, in time of war or national emergency, broad power to monitor and regulate international transactions affecting the nation's monetary and economic security.2/ The breadth and constitution-

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1/ Section 5(b) was originally enacted as part of the Trading with the Enemy Act of 1917 and is frequently referred to as the "Act of October 6, 1917, as amended". It is codified at both 12 U.S.C. 95a and 50 U.S.C. App. 5(b). Its inclusion in the banking title (Title 12) stems from its amendment and reenactment in section 2 of the Emergency Banking Act of 1933. 48 Stat. 1. Thus, where it is desirable to avoid highlighting the "trading with the enemy" character of the statute, official reference is sometimes made to the "Emergency Banking Act of 1933, as amended" (later amendments were added in 1940 and 1941). However, section 2 of the Emergency Banking Act is simply an amendment to the underlying 1917 Act and furnishes no independent authority.

2/ See e.g., Smith v. Witherow, 102 F. 2d 638 (C.A. 3, 1939); Ruffino v. United States 114 F. 2d 696 (C.A. 9, 1940); Pike v. United States, 340 F. 2d 487 (C.A. 9, 1955); Sardino v. Federal Reserve Bank of New York, 361 F. 2d 106 (C.A. 2, 1966).

ality of that statutory delegation to the Executive have been consistently upheld, particularly in cases construing the Foreign Assets Control Regulations 31 C.F.R. Part 500. 3/

The substantive provisions of Section 5(b), grant authority to the President, acting through any agency or by means of any regulation, to --

> (A) investigate, regulate, or prohibit any transactions in foreign exchange, transfers of credit or payments between, by, through, or to any banking institution, and the importing, exporting, hoarding, melting, or earmarking of gold or silver coin or bullion, currency or securities, . . .

Paragraph (A) of the section essentially aims at international transactions of a monetary character. Paragraph (B) conveys power to --

> (B) investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition [,] holding, withholding, use, transfer, withdrawal, transportation, importation, or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, <u>any property in which any foreign country or a national thereof has any interest</u>, . . . (emphasis added)

The jurisdictional reach of both paragraphs, extends to transactions "by any person or with respect to any property subject to the jurisdiction of the United States."

In addition to regulatory authority over international transactions, the President possesses broad authority to require reporting of such transactions. Both paragraphs 5(b)(1)(A) and (B) above permit the President to "investigate" the transactions indentified therein. More specifically, the statute states:

> [T]he President shall, in the manner hereinabove provided, require any person to keep a full record of, and to furnish under oath, in the form of reports

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3/ See e.g., <u>United States v. China Daily News</u>, 224 F. 2d 670 (2d Cir. 1955), cert. denied, 350 U.S. 885 (1955); <u>United States v. Quong</u>, 303 F. 2d 499 (6th Cir. 1962), cert. denied, 371 U.S. 863 (1962); <u>Teague v. Regional Commissioner of Customs</u>, 404 F. 2d 441 (2d Cir. 1968), cert. denied 394 U.S. 977 (1969), reh. denied, 395 U.S. 930 (1969).

> or otherwise complete information relative to any act or transactions referred to in this subdivision either before, during, or after, the completion thereof, or relative to any interest in foreign property, or relative to any property in which any foreign country or any national thereof has or has had any interest, ... (emphasis added)

This provision permits the President or any official or agency he might designate to require reports regarding current or past investment transactions. See In re Indusco, 15 F.R.D. 7, 9-10 (S.D.N.Y. 1953). It has been recognized that while the regulatory powers of Section 5(b) are extremely broad, the reporting powers are, if anything, even broader. Clark v. Edmunds, 73 F. Supp. 392 (W.D. Va. 1947).

With regard to screening of or substantive restrictions on foreign investment here, the reasoning of a 1968 Attorney General's Opinion concluding that a firm legal basis for the Foreign Direct Investment Program was provided by Section 5(b) possesses relevance to inward investment as well (42 Op. Atty. Gen., No. 35, at 9):

> A continual substantial excess of dollar outflows over dollar inflows could undermine the value of the dollar in international commerce and threaten the world's monetary system, which depends upon a stable dollar. The Foreign Direct Investment Program, in seeking to control the flow of investment dollars out of the United States, ... proceeds on the same basis as these earlier orders controlling the outflow of gold and capital in other contexts.

With respect to foreign investment here, an even stronger case than the balance-of-payments argument can be advanced, particularly if the investors are foreign governments and national security related industries are involved.

In particular, the authority conveyed in Section 5(b)(1)(B) to investigate, regulate, or prohibit any transaction in which a foreign country or national thereof has any interest is pertinent to monitoring, screening, or regulation of foreign investment here. The type of "interest" that is amenable to regulation is very broadly construed. see e.g. United States v. Broverman, 180 F. Supp. 631 (S.D.N.Y. 1959) and would extend to purchases of the equity or debt of United States businesses.

The cases have consistently recognized that the foreign state is always a third-party beneficiary of transactions by its nationals that bring foreign capital, particularly in hard currencies, within its borders. That successful foreign direct investment in the United States would result in an eventual outflow of American dollars in the form of investment income to foreign nations is obvious despite the short-term balance of payments benefit to the United States from the initial capitalization of such investments. The cases make clear that the United States interest in control of ultimate movements of its currency resources is a sound basis for the regulation under Section 5(b) of transactions by any person within the jurisdiction of the United States (whether a U.S. national or not) in property in which a foreign country or a national thereof has an interest of almost any kind whatsoever. Insofar as such foreign investments might also impinge on our national security or impair the conduct of our foreign policy, an even stronger case can be made.

One potential drawback in the utilization of Section 5(b) as a statutory underpinning for a regulatory program of potentially indefinite duration is that its authority is operative only during time of war or national emergency, despite the great discretion accorded the President in declaring an emergency. The 1950 emergency declared by President Truman was consistently sustained in the courts for decades after its proclamation.4/ The courts have resisted the impulse to independently determine whether an emergency is stale or to confine its application to a particular set of originating or historical circumstances. Moreover, on August 15, 1971, President Nixon declared a balance-of-payments emergency which has not been terminated (Proc. No. 4074, 36 Fed. Reg. 5724).

No court has as yet ruled that there must be a particular relationship between the nature of an emergency and the Section 5(b) action taken thereunder. However, the charge that such a relationship does not exist has frequently been levelled against specific uses of Section 5(b) powers.

4/ Sardino v. Federal Reserve Bank, 361 F. 2d 106 (2d Cir. 1966), cert. denied, 385 U.S. 898 (1966); Teague v. Regional Commr. of Customs, 404 F. 2d 441 (2d Cir. 1968), cert. denied 394 U.S. 977 (1969), reh. denied, 395 U.S. 930 (1969); Pike v. United States, 340 F. 2d 487, 489 (9th Cir. 1965); United States v. Lane, 218 F. Supp. 459, 461-464 (S.D.N.Y. 1963); Welch v. Kennedy, 319 F. Supp. 945, 947-48 (D.D.C. 1970).

The "emergency" problem could be alleviated by the declaration of a new emergency dealing with the Petrodollar problem. However, despite judicial abstinence to date from re-examining emergency declarations, there is conceptual difficulty in regarding a problem, however serious, which may persist for a decade or more, as an "emergency" not amenable to legislative redress. Litigation and Congressional criticism of a new "emergency" of indefinite duration could be expected. The national emergencies bill which passed the Senate on October 7, 1974 would provide for limitations on the declaration and duration of future emergencies and terminate existing emergency powers within 1 year of enactment. However, by Administration request, Section 5(b) was exempted entirely from the provisions of the bill.

Moreover, despite the broad construction of Section 5(b) by the courts to date, there have been recent adverse decisions that may indicate that the President's exercise of the statute's powers may in the future receive less tolerant scrutiny by the courts.

In March 2, 1973, a federal district court judge ruled orally that Section 5(b) did not authorize an indictment charging a violation of the Foreign Direct Investment Program. United States v. Ryan, Crim. N. 2038-78 (D.D.C. 1973). The Ryan case was settled pending appeal when the investor agreed to file delinquent reports. The district court wrote no opinion and was apparently motivated by the narrow facts of the case rather than an overview of Section 5(b). The case is thus not a weighty precedent, but nonetheless cannot be ignored in assessing judicial risks under Section 5(b).

More importantly, in Yoshida Intl., Inc. v. United States, 378 F. Supp. 1155 (Cust. Ct. 1974), the Court ruled that Section 5(b) did not authorize the President's imposition of an import surcharge in Proclamation 4074 on August 15, 1971. Although the court was partly influenced by what it took to be a conflict with trade legislation, it also took a generally narrow view of Section 5(b). The case is presently on appeal by the Government.

Any use of Section 5(b) involves not only a legal judgment but a policy decision as to whether the program in question is worth the risk of provoking a narrowing of the statute, or the circumstances when it can be used, by the judiciary or by Congress. Section 5(b) is a valuable tool for the Executive which should be used with discretion to avoid any impairment of the authority.

C

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 direct placement of OPEC funds into the corporate sector would have the most immediate effect on the availability of capital in the corporate sector, any net 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 general, 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

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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

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

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