Foreign Direct Investment—An Overview

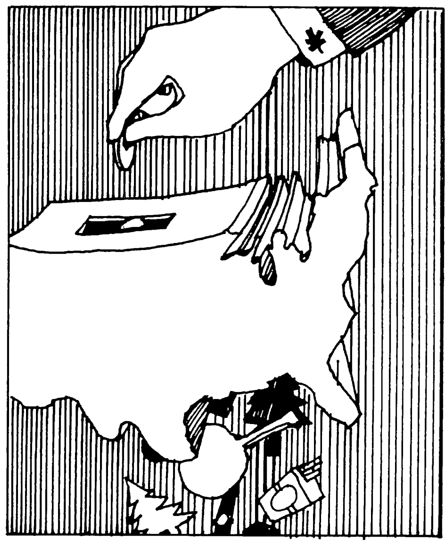
John M. Connor
(202) 447-6363

The United States has long been the leader in making private foreign direct investments (FDI), although American firms now own slightly less than half of the world's stock of FDI, according to a 1978 United Nations report. This is down from a peak of over 60 percent in the 1950's. But, during the last decade, the United States has also become the world's largest host country for FDI, with investments in the food and tobacco manufacturing industries accounting for about 18 percent of total manufacturing FDI in 1979.

FDI—the ownership of a substantial portion of the long-term debt or equity of a foreign corporation—usually implies the ownership and control of one corporation by another larger corporation. Almost all FDI originates from the world's 1,000 largest corporations. They control affiliates by full or partial ownership of voting shares, loans, membership on the boards of directors, royalty and trademark agreements, special service contracts, and the placement of parent-company personnel in key management positions. FDI differs substantially from portfolio investment, which was the dominant form of international investment during the early part of this century. Portfolio investment typically involves the purchase of bonds issued by corporations or governments and gathers the savings of numerous small investors.

FDI into U.S. Food Manufacturing

Defining the food and agricultural system very broadly (including tobacco, forestry, agricultural inputs, and food wholesaling and retailing), USDA economist Kenneth Krause calculated that in 1974 about 1,524 foreign affiliates were involved in the food system, accounting for almost 20 percent of the total assets, half of the sales, and over half of the commodity exports of all foreign affiliates doing business in the United States. Of all U.S. manufacturers, food and tobacco firms had the largest amount of assets controlled by foreign firms. In the retailing sector, foreign firms wholly or partially owned 23 U.S. grocery firms—accounting for nearly 11 percent of total grocery store sales—as of April 1980. (See NFR-13.) Foreign investors have entered



the U.S. food service industry, although to a small extent. (See *Foreign Investment in U.S. Commercial Food Service Industry,* in this issue.)

In 1974, 17 percent of all manufacturing FDI into the U.S. was in food processing and 3 percent in tobacco. This $1.6-billion FDI in food and tobacco processing increased to $3 billion in 1979, an average annual rate of growth of 17 percent over 1974-79. Food manufacturing ranks third among the 20 major industry groups (after chemicals and petroleum) in total inward FDI; tobacco ranks eighth. FDI into U.S. food manufacturing, as a proportion of total manufacturing, appears to have peaked in 1959 at 38 percent. Inward FDI in food manufacturing is only about one-third that of U.S. firms' investments abroad, but the gap closed rapidly during the 1970's.

FDI in U.S. food manufacturing is highly concentrated in terms of its geographical origin—Canada alone invested 33 percent in 1979. Other prominent source countries are the Netherlands (32 percent), the U.K. (16 percent), Switzerland (14 percent), and Belgium (1 percent). Japan accounts for only 1 percent, and all other countries have less. Foreign food and tobacco firms also tend to be located mainly in a few States of the United States. The geographic distribution of employment by foreign food manufacturing affiliates in 1974 was primarily in the States of New York (11 percent), New Jersey (6 percent), Pennsylvania (4 percent), Ohio (4 percent), Illinois (8 percent), California (14 percent), and Washington State (4 percent).

Although much of the total FDI is in the food and tobacco processing industry, foreign affiliates are only a modest portion of this industry. Based on the latest (1974) data, the estimated total assets of foreign food and tobacco manufacturing affiliates were 6.1 percent of the assets of all U.S. food and tobacco manufacturers, according to IRS figures. Their net sales were about 4 percent of the total, but foreign-owned firms in the United States handle more U.S. imports and exports than their sales or asset position would indicate. In 1974, U.S. affiliates of foreign firms sold 24.5 percent of the value of all U.S. merchandise export trade and bought 30.4 percent of all such imports. On average, 36 percent of all exports and 74 percent of all imports of these companies were intrafirm transactions. Most trade by U.S. affiliates is with the parent firms' home country, especially for Canadian and Japanese subsidiaries.

Public Concerns About FDI

Public concerns about inward FDI in the United States are relatively recent. They surfaced during 1973 when rapidly rising oil prices created huge dollar surpluses for the OPEC cartel. Since that time, numerous books, articles, and reports have addressed FDI issues.

There is concern that foreign entities, most of them large multinational corporations (MNC) with highly diversified product lines, make decisions about the use of host-country resources on the basis of a global profit-maximizing strategy. Some of these decisions may clash with the host country's goals of national food security or independence. MNC's, because of their flexibility in setting prices on international trading within the firm, may be able to avoid corporate income taxation in some of the countries where they operate. MNC's generally benefit from reduced trade barriers and may use their influence to oppose restrictions that may be in a particular country's economic interest. Because foreign food manufacturing plants are typically located in the more industrialized areas of the United States, development goals for less wealthy areas may be difficult to achieve.

A second group of concerns arises from the ease with which MNC's transfer technology internationally. The food industries are often regarded as "key" industries. Countries that have a comparative advantage in production or marketing technologies can lose it quickly if a leading firm is acquired. Also, MNC's have a tendency to perform most of their research and development in their home countries, so FDI could alter national scientific and technological capacities. For example, some European companies with U.S. investments appear to have the lead in biotechnologies, with important applications to food processing.

The looming importance of MNC's in international trade and finance raises a third set of issues. Initially, the balance of payment effects of FDI are "favorable" to a host country as capital flows in. But, over time new payments are increasingly financed from local savings, and dividend and royalty payments to overseas investors begin to outweigh the new investments and the initial investment as well. Also, MNC's tend to view investments as an alternative to exporting; in the long run, national efforts to improve the balance of trade could be frustrated.

Increasing intrafirm trade and vertical integration by MNC's may mean that open transactions for some food inputs will become a small portion of total transactions. Over time this could affect the pricing efficiency of cash and futures markets for agricultural commodities. Finally, the vast pool of liquid resources may encourage instability or speculation in international financial and currency markets, especially if the number of MNC's remains relatively small.

A fourth set of imponderables is the effect of FDI on competition. Interbehavior among a few large firms in national markets may, because of inward FDI, evolve into a similar anticompetitive situation on an international scale. In the 1970s, for example, Europe's largest frozen food manufacturer acquired one of the leading U.S. frozen foodmakers. If the merger had been initiated

Geographic Ownership of the Stock of Foreign Direct Investment in the U.S. Industries, 1979

Country or country groups	All manufacturing except petroleum		Food manufacturing	
	Amount	Proportion	Amount	Proportion
	Mil. dollars	Percent	Mil. dollars	Percent
Canada	3,617	18.1	838	32.7
Netherlands	3,503	17.5	809	31.6
United Kingdom	3,466	17.3	398	15.5
Switzerland	2,164	10.8	360	14.1
Belgium	201	1.0	26	1.0
Germany	2,440	12.2	15	0.6
Italy	13	0.1	10	0.4
France	1,068	5.3	-15[1]	-0.6
Other Europe	613	3.1	5	0.2
Japan	722	3.6	32	1.3
Latin America	2,088	10.4	79	3.1
Africa, Asia, and Pacific	115	0.6	4	0.2
All areas	20,029	100.0	2,562	100.0

[1]Negative sign means that loans to the parent companies exceed equity in the affiliates.

Source: *Survey of Current Business*, August 1980.

Foreign Direct Investment in the U.S. Food and Tobacco Manufacturing Industries[2]

Year	Value of foreign direct investment: Food manufacturing	Tobacco manufacturing	Total as a proportion of all manufacturing
	Million dollars		Percent
1934	64	13[1]	14
1937	97	19	16
1941	150	29	24
1959	758[1]	173[1]	38
1974	1,384	244[1]	20
1977	1,834	324[1]	16
1979	2,562	452[1]	18

[1]Estimated from other ratios and residuals.

[2]Every year prior to 1974 available was used.

Source: Wilkins (1977); Department of Commerce (1976); *Survey of Current Business*, various years.

by a U.S. firm, it could have been easily prevented by U.S. authorities. Though the merger was challenged, no strong remedy could be granted by the courts because markets are legally defined by national boundaries in legal matters. MNC's, on the other hand, often view their markets in global terms.

U.S. Policies Toward FDI

The United States has traditionally espoused a policy officially characterized as "neutral" toward inward FDI. Once a foreign company makes the investment, it is treated the same as a U.S.-based company. However, prior to the initial investment, not all proposed foreign investments are treated equally. The United States restricts foreign entry into several industries, such as weapons industries, atomic energy facilities, energy extraction in federally supervised areas, some types of fishing and shipping, and in the regulated communications and airlines industries.

There are no restrictions on foreign investment in mining or energy extraction on private lands (including uranium), newspapers and magazines, agricultural land, banking, and several other activities generally closed to foreign investors in other countries. Foreign affiliates are treated as domestic firms with respect to securities regulation, taxation, and antitrust enforcement. However, the extent of "extraterritoriality" in U.S. antitrust laws is still untested; in theory, any act that affects U.S. commerce, including acts outside the United States, is covered by these laws, thus jeopardizing the U.S. assets of a foreign company that violates the law.

The heightened concern during the 1970's over foreign investment into the United States resulted in several new disclosure requirements for foreign investments. The Department of Commerce is now authorized to collect comprehensive data on both inward and outward FDI every 5 years, with supplementary annual surveys, and USDA is authorized to collect and analyze data on foreign ownership of U.S. land. The Interagency Committee on Foreign Investment in the United States was set up in 1975 to coordinate U.S. policies. Because of the use of tax haven countries for foreign ownership, other laws now require disclosure of the ultimate beneficial owners of an asset. Using this authority, a report on 1979 FDI by the International Investment Division found that a considerable portion of FDI attributed to residents of the Netherlands Antilles was ultimately owned by residents of several OPEC countries.

During 1976-77, over 40 bills were introduced in Congress calling for increased data collection, disclosure, controls, or screening of inward foreign investment. Many of these bills were reintroduced in the current session of Congress, but even though FDI is higher than ever, interest in new restrictions is not as keen as it was 2 or 3 years ago. Various proposals for screening new investments may have the most support. Some are based on the model of the Canadian Foreign Investment Review Agency (FIRA) established in 1974. FIRA approves foreign investment proposals on a case-by-case basis if they are expected to foster greater national income, employment, exports, domestic efficiency and variety, competition, and Canadian ownership, and are compatible with other national policies. FIRA now screens about 800 investments per year, and over 80 percent of the proposals are approved. Rejected firms can negotiate new terms in confidential proceedings. An extraterritorial feature of FIRA rules may require divestment of Canadian assets if the foreign parent is involved in a merger not regarded as in Canadian interests.

The Canadian model may provide a solution to the problem of improving national benefits from inward FDI. However, the effectiveness of screening has not been adequately assessed, and adoption of such a program would require abandonment of the overriding U.S. principle of "neutrality" if it were to be applied to established affiliates as well as new foreign investment. Moreover, screening involves increased regulation that is likely to discourage a few investments. These features, combined with the fact that the U.S. State Department is charged with facilitating foreign investment, make adoption of investment screening unlikely at this time, according to a 1980 report by the General Accounting Office. ■

References

Bergsten, C. Fred, Thomas Horst, and Theordore H. Moran. *American Multinationals and American Interests.* Washington: Brookings.

CTC (Commission on Transnational Corporations, United Nations). *Transnational Corporations in World Development: A Re-Examination.* New York: United Nations.

Comptroller General. *Foreign Direct Investment in the United States—The Federal Role.* Washington, D.C.: General Accounting Office.

__________. *Domestic Policy Issues Stemming From U.S. Direct Investment Abroad.* Washington, D.C.: General Accounting Office.

__________. *Controlling Foreign Investment in National Interest Sectors of the U.S. Economy.* Washington, D.C.: General Accounting Office.

Connor, John M. *The Market Power of Multinationals.* New York: Praeger.

Foreign Economic Policy Subcommittee, Committee on Foreign Affairs, U.S. House of Representatives. Hearings on *Foreign Investment in the United States.* Washington: U.S. GPO.

Helleiner, G. K. and R. Lavergne. Intra-Firm Trade and Industrial Exports to the United States. *Oxford Bull. Econ. Stat.* 41: 297-312.

Howenstein, Ned G. Selected Data on the Operations of U.S. Affiliates of Foreign Companies, 1977. *Survey of Current Bus.* July: 32-44.

International Investment Division. U.S. Business Enterprises Acquired or Established by Foreign Direct Investors in 1979. *Survey of Current Bus.* January: 28-39.

Krause, Kenneth R. *Foreign Investment in the U.S. Food and Agricultural System: An Overview,* Agr. Econ. Report No. 456. Washington: ESCS, USDA.

OFIUS (Office of Foreign Investment in the United States). *Foreign Direct Investment in the United States: 1979 Transactions* and previous issues. Washington, D.C.: International Trade Administration, U.S. Department of Commerce.