The Dynamics of U.S. Inward Foreign Direct Investment Policy:

National Security, Economic Competitiveness, and the Politics of Structural Choice

A Dissertation
Presented to the Faculty of the Graduate School
of
Yale University
in Candidacy for the Degree of
Doctor of Philosophy

by
Choo Soon Kang

Dissertation Director: David R. Cameron

December 1994

UMI Number: 9522681

UMI
300 North Zeeb Road
Ann Arbor, MI 48103

Abstract

The Dynamics of U.S. Inward Foreign Direct Investment Policy: National Security, Economic Competitiveness, and the Politics of Structural Choice

Choo Soon Kang

1994

This study examines the dynamics of U.S. inward foreign direct investment policy. It explores the rise of acquisitions of U.S. companies and assets by foreigners, particularly the Japanese, as a contentious foreign economic policy issue and analyzes the policy shifts in the past two decades that have changed the character of U.S. regulations targeting inward direct investments from that of benign neglect to one of cautious activism driven by the politics of economic competitiveness.

More broadly, this study explores foreign economic policymaking in advanced industrial democracies. By taking a "new institutionalist" approach to analyzing the U.S. inward foreign direct investment policy, this study examines the vital role played by elected policymakers in the foreign economic policymaking process. Indeed, such an approach helps to clarify how the growing conviction among U.S. politicians that economic security is a crucial element of national security and their perception that economic competitiveness is an increasingly important electoral issue have driven the U.S. policy toward incoming direct investments from that of liberal encouragement to that of discretionary restrictions in some sensitive sectors of the domestic economy.

In memory of my father,
who wanted me to be a scholar

Contents

Tables

Acknowledgements

In writing this study, I have received support from many individuals and institutions. They deserve only gratitude and none of the blame for the shortcomings of this study.

First, I would like to offer my heartfelt thanks to my professors at Yale: David Cameron, the dissertation director, Sylvia Maxfield, David Mayhew, Steven Smith, David Plotke, now at the New School for Social Research, and Mike Mochizuki, now at RAND. Over the years, they have provided me with all kinds of assistance and helped me grow as a scholar. I would also like to thank Kent Calder at Princeton who critiqued the prospectus for this dissertation. Also, John Steinbruner, Thomas McNaugher, Edward Lincoln, Kenneth Flamm, Wolfgang Reinicke, and Lincoln Gordon of the Brookings Institution deserve thanks for their interest in my work and helpful comments. Special thanks, however, must be reserved for Peter Cowhey. Indeed, it was his "political choice theory" that provided the intellectual spark for this study.

In conducting interviews and gathering data, my stint as an investment banker specializing in mergers and acquisitions during the "go-go" years of the late 1980s proved invaluable. I made full use of my contacts on Wall Street to obtain information, opinions, and suggestions. I particularly want to acknowledge the assistance of my friends and old colleagues at Dillon, Read & Co. Equally valuable was my tenure as a research fellow at the Brookings Institution in Washington, D.C. My affiliation with the Foreign Policy Studies Program there opened many doors and yielded many return phone calls from government officials, lobbyists, policy-analysts, and other functionaries populating the nation's capital.

My greatest debt of gratitude, however, is owed to my family. Without question, their moral support was essential to the completion of this project. They were always encouraging and ever patient. My brother-in-law, Jonathan Huneke, deserves special mention for his tireless help with my research.

C.S. ELIOT KANG

Naperville, Illinois

CHAPTER ONE

Introduction

This study examines the politics of foreign direct investment in the United States. It explores the rise of acquisitions of U.S. companies and assets by foreigners as a contentious foreign economic policy issue in recent years. Specifically, it investigates the policy shifts in the past two decades that have changed the character of government regulation targeting inward direct investment from that of benign neglect to one of cautious activism driven by the politics of economic competitiveness.

More broadly, this study explores foreign economic policymaking in advanced industrial democracies. There is already a substantial body of scholarly research on the subject employing a wide variety of theoretical approaches. However, surprisingly little attention has been paid in the literature to the central role of elected politicians in the foreign economic policymaking process. Given the power wielded by office-holding politicians in industrialized democracies, this neglect constitutes a serious gap in the scholarly effort.

By taking a "new institutionalist" approach to analyzing the U.S. inward foreign direct investment policy, this study examines the vital role played by elected policymakers in the foreign economic policymaking process.

Indeed, such an analytical approach helps to clarify how the growing conviction among U.S. politicians that economic security is a crucial element of national security and their perception that economic competitiveness is increasingly becoming a salient electoral issue have driven the U.S. policy toward incoming direct investments from that of liberal encouragement to that of discretionary restrictions in some sensitive sectors of the domestic economy. In so doing, it also provides an interpretive intellectual architecture useful in analyzing the larger predicament of U.S. policymakers caught between the postwar commitment to the maintenance of the liberal world economy and the new demands of the emergent politics of economic competitiveness.

The Lay of the Land

From the end of World War II to the early 1970s, the character of U.S. policy toward inward foreign direct investment had been that of general openness. Despite periodic official pronouncements that the fundamental policy of the United States toward international investment is one of strict neutrality, policymakers in Washington tended to look favorably upon incoming direct investments.[1]

As a rule, policymakers assumed that any firm, foreign or domestic, seeking to expand or acquire for commercial reasons will make a net contribution to the nation's economic welfare. With the exception of

[1]For a typical policy statement, see National Advisory Council's *Annual Report to the President and to the Congress for 1977* (Washington, D.C.: Government Printing Office, 1978), pp. 84-6.

restrictive regulations covering investments originating from Eastern bloc countries and few others considered by the United States as pariah states, the U.S. policy was marked by the effective absence of controls often employed by other countries. This general *laissez-faire* policy posture reflected the liberal ideological foundation of the postwar U.S. foreign economic policy, the reality of U.S. economic preeminence, and America's political and military leadership of the Western alliance against international communism.

The policy equilibrium was disturbed during the 1970s when there was a surge of direct investments coming into the United States. The immediate cause of this break was the political reaction to the return, in the form direct investment, of a portion of the huge petrodollar surplus accumulated by the nations of OPEC that had just engaged in a politically motivated embargo on the West. Not as politically dramatic, but more important in the long run, was another factor: By the early 1970s, there was a new level of vigor to direct investment activities in the United States by foreign transnational firms determined to learn new production and marketing skills in the world's most advanced market.

Combined with the lessening of Cold War tensions and the decline in American economic competitiveness, which had become clearly evident by the early 1970s, this surge of foreign direct investment activities in the United States-- driven by both short and long term factors just discussed-- set the stage for some telling modifications in the U.S. policy posture. While the regulatory efforts were spasmodic and inchoate, from the mid 1970s, the federal government began to scrutinize the level and the content of inward investment flows with a degree of seriousness absent from the earlier period.

Of course, the regulatory pressure abated when the level of OPEC investments in the United States declined. However, the pressure increased again strongly during the mid 1980s when the relative decline of U.S. competitiveness became quite pronounced and the level of direct investments coming into the United States reached new heights due to "piling up" of long-term global economic trends. Furthermore, as the U.S. economic power waned, the reason for foreign firms investing in the United States became increasingly political in nature: Some foreign firms made direct investment in the United States to sidestep trade barriers and other regulatory obstacles put into place in order to protect no longer competitive, but politically powerful, U.S. companies.

However, it was quite clear by the late 1980s that the more localized political reasons for the increasing the level of direct investment activities worldwide were not as significant as the coming together of larger economic forces. In this period, there was cascading of investment flows from more nations into more sectors and industries because there was a dramatic increase in the number of firms worldwide involved in investing abroad.[2] The increase in direct investments coming into the United States was simply part of this larger global economic trend.

The reality was that, by the late 1980s, the markets for many goods and services had become truly international. It was also quite clear by then that, in many key industries, only a handful of world-class firms would be able to independently bear the financial risks or command the range of technologies needed to win a profitable share of the global market. In fact, by that time, more firms in the high technology sector were relying on direct investments

---

[2]DeAnne Julius, *Global Companies & Public Policy: The Growing Challenge of Foreign Direct Investment* (New York: Council on Foreign Relations Press for The Royal Institute for International Affairs, 1990), p. 6.

abroad to establish strategic business alliances and for obtaining technology, parts, and product variety than ever before.

These high technology firms as well as others were investing not only to win market shares abroad, but to maintain competitiveness at home. As one top manager of a large U.S. manufacturer explained the situation, "Today, you need to do onto others on their own turf before they surely will do onto you on yours."[3] The fact is, a company need not be a large transnational corporation to worry that unless its foreign competitors are challenged in their own home markets, the uncontested rents they earn may be used to finance the entry into its own home market.

In the wake of the explosion of worldwide investment activities by transnational corporations during the 1980s, the share of U.S. manufacturing assets controlled by foreigners nearly doubled to constitute more than ten percent of the total.[4] This upsurge of direct investments coming into the United States, not just as an important economic phenomenon but as the stuff of newspaper headlines and popular magazine covers had a telling impact on the U.S. inward foreign direct investment policy: The effort to regulate foreign direct investment in the United States, if spasmodic and inchoate during the 1970s, became more focused during the late 1980s.

Alarmed by the unprecedented level of trade deficits and mindful of the widespread public fears about the vulnerability of U.S. firms to "takeovers" by foreign firms with different industrial organization from

---

[3]Personal interview.

[4]The advance of transnational corporations slowed during the 1970s because of the economic problems associated with the oil and other commodity price instability beginning in 1973. See Raymond Vernon, "Are Foreign-owned Subsidiaries Good for the United States?" Occasional Papers No. 37 published by Group of Thirty, Washington, D.C., p. 1.

domestic ones, many policymakers in Washington came to link the rapid rise of foreign direct investment in the United States with the issue of national competitiveness and made it an integral part of the politically-charged trade policy debate. The elected policymakers in Congress and the White House became partners, if reluctant and often quarreling ones, in taking a more activist approach toward the regulation of incoming investments in the name of national security during the late 1980s.

It is ironic that, while the disappearance of the Soviet Union as the central Cold War adversary made it possible for the United States to begin liberalize and promote commercial relations with former-communist countries in recent years, many policymakers have begun to question the benefits of direct investments from its erstwhile anti-communist allies, especially Japan, for reasons of national security. Indeed, until 1988, the federal restrictions on foreign direct investment were only applied to those industries subject to federal regulation. However, through several provisions of the Omnibus Trade and Competitiveness Act of 1988-- in particular the Exon-Florio amendment-- policy activists in Congress, with executive branch complicity, succeeded in putting into place a regulatory mechanism to screen foreign direct investment in any sector of the U.S. economy.

For the first time in its history, the United States now has a screening mechanism built around an obscure bureaucratic entity called Committee on Foreign Investment in the United States (CFIUS) that can monitor and has the power to ban or set conditions on foreign investment in any sector of the economy. Of course, under the Trading with the Enemy Act, the president has had the ability to stop undesirable foreign direct investment in the United States since 1917. However, the act of prohibiting a friendly or allied nation's investment in peacetime under this authority would be extraordinary to say the least, not to mention illegal unless a national emergency has been declared.

These provisions creating the apparatus announced to the world that there were assets and commercial activities that the United States did not want to fall into foreign hands, even friendly ones. However, they did not precisely indicate what these assets and activities were. Neither did they clearly establish concrete criteria on which a foreign purchase may be banned or made conditional on some requirement. This very ambiguity gives the new mechanism great potential power to expand the scope and depth of regulation. The ambiguity is also an indication that the mechanism remains a politically contested bureaucracy, rendering any unqualified prediction about policy outputs and the effectiveness of these outputs highly problematic.

As it has been constituted since the early 1990s, the regulatory machinery built around CFIUS-- though *ad hoc* in its style of operation-- routinely receives information about pending foreign acquisition of domestic asset. It has the power to review and, if it deems the transaction contrary to the interest of the United States, block the purchase.[5] While it has acted formally on only a small number of transactions, its scrutiny has led to a number of instances where the foreign buyer ended up withdrawing from a "done-deal" or modifying the terms of investment.

According to some, the very existence of the mechanism may be having the effect of discouraging some investments from being considered at all. Mergers and acquisitions specialists on Wall Street point out that, since the passage of the Exon-Florio amendment, their foreign clients have become

---

[5]The president ultimately decides what action to take based on the recommendation of CFIUS.

wary of even contemplating certain kinds of investment in the United States.[6] With its opaque and highly discretionary operating style, by the early 1990s, the regulatory apparatus had become something of a *de facto* screening mechanism that can not only bar but set performance requirements on foreign investment.[7]

To be sure, the United States has had long-established safeguards against foreign control of certain categories of domestic assets deemed vital to security, including the already mentioned Trading with the Enemy Act. While many of them are nominal or now anachronistic, the United States has laws-- some dating back to the nineteenth century-- protecting to varying extent those assets traditionally regarded by nation-states as vital to national defense, such as those in sectors involved in energy production, communication, transportation, and few others.[8] The United States also has laws, which it has enforced more vigorously, controlling the harmful effects of foreign investment that involves the transfer of defense-related classified and sensitive information and technologies.

The recent policy movement toward a tighter regulatory regime, however, has been far more comprehensive in the scope of its coverage and urged ostensibly for "economic security," a notion of national security beyond the traditional concept based on military preparedness. In the words of Les Aspin, the United States is now experiencing "the emergence of an entirely

---

[6]Personal interviews with investment bankers and lawyers specializing in international mergers and acquisitions.

[7]One seasoned lobbyist for U.S. manufacturers describes its *modus operandi* as "almost 'Star Chamber'-like." Personal interview.

[8]In recent years, with government deregulation of many regulated industries, there has been a trend toward liberalizing some of these restrictions. For instance, the Department of Transportation has eased some restrictions on foreign ownership of domestic air carriers.

new concept of national security [which] embraces economics and competitive, commercial relations."[9] In fact, at the heart of the current debate over "economic security" is the question whether what a nation produces-- that is, the sectoral composition of its economy-- is of any consequence to the balance of power among nations.

The United States, of course, remains fundamentally open to investments from abroad: It is still one of the most liberal nations in the world in terms of its policy attitude toward the right of establishment and national treatment of foreign direct investment. The United States has long supported the position that a firm from one nation should have the unimpeded ability to establish subsidiaries in other countries, and once established, these subsidiaries should receive the same treatment as domestic firms. Nonetheless, it is difficult to ignore the recent buildup of restrictionist regulations and the growing legitimacy of the view among policymakers that, when it comes to insuring national security in the "New World Order," economic security is a vital consideration and the government can and should take measures to safeguard economic competitiveness.[10]

---

[9]Quoted in John Greenwald, "Friends or Foe?" *Time*, April 24, 1989, p. 44.

[10]In recent years, there has been a flood of works highlighting economic competitiveness as the foundation of national power. For example, Richard Rosecrance's *The Rise of the Trading State: Commerce and Conquest in the Modern World* (New York: Basic Books, Inc., 1986) and Paul Kennedy's *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Random House, 1987). More typical of the works appearing after the breakup of the Soviet Union is C. Fred Bergsten's "The Primacy of Economics," *Foreign Policy*, No. 87 (Summer 1992), pp. 3-24. Of course, Bill Clinton's successful campaign for the White House was buoyed by his call for economic competitiveness. With respect to inward foreign direct investment, it is not surprising that the very first item on the agenda of his newly created National Economic Council may have been the reversal of a secret, last-minute decision by the outgoing Bush administration to approve Nakamichi Peripherals Inc. of Japan's purchase of a unit of the Applied Magnetics Corporation, the only U.S. company producing the main component for computer laser disk drives in the United States and which had just developed a new generation of laser disk drive technology. For details, see Keith Bradsher, "U.S. Seeks To Reopen Japan Deal," *The New York Times*, January 26, 1993.

The Argument

The key questions the present study seeks to answer are these: First, what accounts for the recent shift in the U.S. policy toward inward foreign direct investment from that of benign neglect to that of discretionary restrictions in certain sensitive sectors of the domestic economy? And second, why has this policy shift taken the shape that it has? That is, what accounts for the creation of CFIUS as the central instrumentality of U.S. inward foreign direct investment policy? Although these two questions appear separable and analytically distinct, they are in fact intimately linked to one another.

The answer to the first question is lodged somewhere at the intersection of international systemic forces and domestic politics. Indeed, the transformation of the international power structure in recent decades provides a part of the answer. Systemic changes certainly account for the increasing U.S. sensitivity to international economic competition. However, for a more complete answer, domestic political factors must be taken into account. It is the domestic political process that gives specific shape to national policy responses to changes in the global environment. And it is here that the answer to the second question also provides a satisfying answer to the first.

This study asserts that elected national leaders, namely the president and key members of Congress, critically affect the dynamics of an important element of U.S. foreign economic policy: the U.S. inward foreign direct investment policy.[11] Hence, the study contends that the recent policy activism toward inward foreign direct investment can be explained by two complexly interlinked factors: One is the growing awareness among elected policymakers that economic competitiveness is a crucial element of national security; and the other is the policymakers' perception that this competitiveness issue is becoming increasingly important to national electoral politics.[12]

It is the elected policymakers, as agents of the electorate and principals animating various administrative institutions of government, who have caused the U.S. inward foreign direct investment policy to take the particular direction and shape that it has. Indeed, it has been the combination of the changing electoral calculations of elected officials as career politicians and the partisan conflicts among themselves as policymakers that account for the dynamics of the U.S. inward foreign direct investment policy in the past two decades, particularly the creation of CFIUS as an imperfect (in terms of policy rationality) but politically workable compromise among contending policymakers.

---

[11]The argument here is inspired by Peter Cowhey's effort to incorporate the insights of "new institutionalism" to the study of foreign economic policy. It has also benefited from Terry Moe's views on the U.S. presidency. See Peter F. Cowhey's "'States' and 'Politics' in American Foreign Economic Policy" in John S. Odell and Thomas D. Willett, ed., *International Trade Policies: Gains from Exchange between Economics and Political Science* (Ann Arbor: The University of Michigan Press, 1990), pp. 225-51 and Terry M. Moe's "President, Institutions, and Theory," in George C. Edwards III, John H. Kessel, and Bert A. Rockman, eds., *Researching the Presidency: Vital Questions, New Approaches* (Pittsburgh: University of Pittsburgh Press, 1993), pp. 337-85.

[12]Here "electoral politics" incorporates the implication the *potential* (versus, *existing*) preference of the electorate has on politicians' decisions. See R. Douglas Arnold, *The Logic of Congressional Action* (New Haven: Yale University Press, 1990).

Elected National Policymakers

The explanation presented here obviously combines different levels of analysis and interweaves several theoretical perspectives; nonetheless, it clearly emphasizes domestic politics and its impact on elected policymakers. As Robert Putnam and others argue, it is important to recognize the "Janus" nature of foreign economic policymakers.[13] However, this study stresses the fact that, in advanced industrial democracies, elected policymakers tend to favor his or her domestic calculus if a choice must be made, not least because of electoral calculations.

Of course, as the first step, the investigation of the questions posed here-- particularly the first-- starts with the analytical assumption that the structural dynamics of interstate relationships has an impact on foreign economic policy of nation-states. Nevertheless, as even structuralists recognize, it is only to the extent that the dynamics of a system limits the freedom of its units that their action and the outcomes of their action become predictable.[14]

The shifting parameters of the U.S. inward foreign direct investment policy is undoubtedly linked to the larger dynamics of the international system. That is, the policy adjustment is linked to the changing balance of power in the world system and represents America's response to its declining relative power *vis-à-vis* its global economic competitors. However, this

---

[13]Robert D. Putnam, "Diplomacy and domestic politics: the logic of two-level games," *International Organization*, Vol. 42, No. 3 (Summer 1988), p. 459. See also Peter B. Evens, Harold K. Jacobson, and Robert D. Putnam, eds., *Double-Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: University of California Press, 1993).

[14]Kenneth N. Waltz, *Theory of International Politics* (New York: Random House, 1979), p. 68.

systemic consideration cannot by itself explain the specifics of U.S. policy choice and goals.

The changing global landscape may provide the necessary context but not the sufficient explanation for the particular policy choice of the United States.[15] As Peter Katzenstein points out, the domain of national policymakers and the nature of national policymaking process must be taken into account if the specifics of the policy are to be made intelligible.[16] Analytical approaches based solely on structural factors often fail to satisfactorily link structure with actual policy decisions.[17]

Limits of the Neostatist Approach

The neostatist approach, which has dominated the study of the formulation of foreign economic policy in recent years, provides some insights as to how to think about the domain of national policymakers, particularly in its focus on the internalization of the dynamics of the world system and its emphasis on the relative autonomy of government officials and institutions from societal pressures in formulating foreign policy.[18] As

---

15As Waltz states, "the behavior of states and statesmen, however, is indeterminate." *Ibid.*

16Peter J. Katzenstein, "International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States," *International Organization* Vol. 30, No. 1 (Winter 1976), pp. 1-45.

17Of course, on the other hand, extrapolating international behavior of nations only from domestic considerations is problematic because even domestic actors make cost-benefit calculations about the impact of international constraints when determining their preferences.

18Influential neostatist analyses of the international political economy include Peter J. Katzenstein, "Conclusion: Domestic Structures and Strategies of Foreign Economic Policy," in Peter J. Katzenstein, ed., *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Madison: University of Wisconsin Press, 1978), Stephen Krasner, *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Berkeley: University of California Press, 1978), and more recently, G. John Ikenberry, "Conclusion: An

John Ikenberry, Stephen Krasner, and other neostatists claim, often officials embedded in key institutions of government are instrumental in interpreting the nature of international pressures and imperatives and may be able to activate and reshape the play of societal groups, influence the character of their preferences, or ignore them altogether in the policymaking process, especially in matters of national security, the first *raison d'etre* of state.[19]

In this internalization process, however, neostatists tend to overemphasize the "state," as an organizational structure, at the expense of "government," as a creature of political exigencies. They also tend to arbitrarily exclude the legislature from the "state."[20] Their narrow focus on the role of "an elite group of executive branch officials and institutions" means that, when they analyze policymaking in the United States, they ignore how foreign policy goals and institutions are often designed to serve the strategic interests of elected officials in Congress, not just those of the president and elite executive branch bureaucrats, in the context of national politics. As James Lindsay argues, "the Hill matters" in making foreign policy, particularly foreign economic policy.[21]

By relegating legislators, and elected officials in general, to peripheral roles in their analysis of foreign economic policymaking, neostatists ignore how elected officials in advanced industrial democracies resolve collective choice problems present in all kinds of policymaking process by creating

---

Institutional Approach to American Foreign Economic Policy," *International Organization*, Vol. 42, No. 1 (Winter 1988), pp. 219-43.

[19]Ikenberry, *op. cit.* Krasner, *op. cit.*

[20]For example, Krasner, *op. cit.*

[21]See James M. Lindsay, "Congress and Foreign Policy: Why the Hill Matters," *Political Science Quarterly*, Vol. 107, No. 4, pp. 607-28.

procedures and hierarchies where these "institutional solutions" in turn shape the substance of policy outcomes-- whether the outcomes are rational or otherwise. Privileging foreign policy, they overestimate the rationality of a nation's response to international incentives and pressures and underestimate the electoral imperatives that pervade public policymaking in industrialized democracies. Indeed, by emphasizing in their studies simply executive officials and institutions, they neglect politics and its impact on policy outcomes.

As Peter Cowhey points out, the neostatist dismissal of domestic politics as "irrational" (in term of national interest) or pork barrel politics is largely based on a critique of now dated interest group theories in the tradition of Schattschneider and Bentley.[22] In fact, with regard to the United States, neostatists often equate Congress with societal interests. Hence, they are forced to argue that its leadership must differ from the "rational strategic perspective" of the White House and the executive bureaucracy and, by implication, is not as crucial to understanding U.S. foreign policy, including foreign economic policy.

Structural Choice Alternative

Inspired by insights about policy choice generated by scholars such as Gary Cox, Mathew McCubbins, Roger Noll, Barry Weingast, and others plowing a promising plot in the field of "new institutionalism," the key component of the multifaceted analytical approach here focuses on elected national policymakers who create, yet are limited by, rules and institutions. Driven by electoral imperatives, yet mindful of the incentives and constraints

---

[22]Cowhey, *op. cit.*, p. 231.

of the international system, it is the elected officials, as those who hold ultimate political power in advanced industrial democracies, who make critical foreign economic policy choices.[23]

Foreign economic policy does not simply fall out of what "statesmen" and "state institutions" might attempt in pursuit of the balance of power. Rather, as with many other types of policymaking in democracies, foreign economic policymaking is beset by collective action problems, and elected politicians respond to such problems by designing regulatory agencies in ways which will not just meet policy goals but further their own political objectives.[24]

As Peter Cowhey argues, elected policymakers determine the amount and types of discretion granted to foreign economic affairs bureaucracies in a manner consistent with their respective political calculations and anticipated problems of overseeing delegated powers.[25] In this scheme, the foreign policy apparatus arises out of politics. It is not a given as in the neostatist formulation of "the state bureaucracy." Its design reflects the values, interests, and strategies of those who exercise ultimate political power in a democracy.[26]

---

[23] *Ibid.*, p. 232.

[24] New institutionalism seeks to discover how different institutional forms affect policy outcomes. See Mathew McCubbins, Roger Noll, and Barry Weingast, "Structure and Process, Politics and Policy: Administrative Arrangements and Political Control of Agencies," *Virginia Law Review*, Vol. 75 (March 1989), pp. 431-82. Also Mathew McCubbins and Thomas Schwartz, "Congressional Oversight Overlooked: Police Patrol Versus Fire Alarms," *American Journal of Political Science*, Vol. 28 (February 1984), pp. 165-79.

[25] Cowhey, *op. cit.*, p. 233.

[26] Even some observers of Japan are beginning to see that, despite appearance and a mountain of literature to the contrary, politicians, not just state-bureaucrats, run the country. See the overview essay in Samuel Kernell, ed., *Parallel Politics: Economic Policymaking in Japan and the United States* (Washington, D.C.: The Brookings Institution, 1991). For a review of the

The sort of "structural choice" approach advocated here captures a critical dimension of the dynamics of U.S. inward foreign direct investment policy that is missed by commonly employed analytical approaches.[27] The approach links the calculations of elected policymakers caught between the historical U.S. commitment to the goal of liberal world economy and the new compelling demands of the emergent politics of economic competitiveness as the economic influence of the United States in the world system diminishes and domestic interests realign themselves as the result of fundamental changes taking place in the increasingly interdependent global economy.

Indeed, while the reduced economic stature of the United States is producing much anxiety about the future among Americans, even the most competitive leading-edge domestic industries are demanding a more activist role for the federal government as a partner in the international economy. And many political leaders are responding to the demand not just to champion a policy agenda that they see as a vital national security and welfare matter but in order to enhance their political standing with an electorate which is increasingly inclined to believe that U.S. industries have fallen behind in international competition not because of lack of effort or ability but because other countries are using unfair means to propel their own industries.[28]

---

contending arguments on who governs Japan, see Michio Muramatsu and Ellis Krauss, "Bureaucrats and Politicians in Policymaking: The Case of Japan," *American Political Science Review*, Vol. 78 (March 1984), pp. 126-46.

[27]Cowhey terms his approach, "political choice theory." However, "structural choice" label better describes the merger of public choice theory and concern for how political institutions (or "structures") impact policymaking.

[28]Klaus Stegemann, "Policy rivalry among industrial states: what can we learn from models of strategic trade policy?" *International Organization*, Vol. 43, No. 1 (Winter 1989), p. 78.

CFIUS and the Politics of Structural Choice

Given this political context, it is not too difficult to see that the recent policy activism toward inward foreign direct investment is part and parcel of the emergent politics of economic competitiveness. As part of the Omnibus Trade and Competitiveness Act of 1988, the passage into law of various measures enhancing the authority and capacity of CFIUS is one of the most visible policy outcomes of this politics. The growing public fear of unstoppable Japanese economic and technological challenge and the realization by many enterprising politicians that the issue of economic security may be utilized for electoral purposes have directly impacted CFIUS. In fact, the form and operation of CFIUS reveal the fundamental politics underlying the content and direction of the U.S. inward foreign direct investment policy more than the policy's rationality or effectiveness.

Much can be learned about foreign economic policymaking in the United States by analyzing the institutional history and workings of CFIUS. As it will be detailed in due course, a group of policy entrepreneurs in Congress cajoled CFIUS from a reluctant president during the 1970s as an institutional manifestation of the political compromise struck between themselves and the White House regarding the regulation of inward foreign direct investment. However, with competitive pressures from abroad only increasing and the public growing wary of foreign economic competition (both fair and unfair), a new group of policymakers in Congress revisited with the White House the terms of the initial compromise in recent years.

During the late 1980s, interested policymakers in Congress attempted to strengthen the CFIUS mechanism as one way to assure their supporters (and *potential* supporters) adversely affected by foreign economic competition that economic competitiveness concerns would receive more political attention from the federal government. From the other end of the Pennsylvania Avenue, however, the president acquiesced to this new round of congressional initiatives concerning inward foreign direct investment only to the extent that it did not jeopardize the president's leadership role in carrying out foreign economic policy, particularly White House supervision of executive branch agencies in foreign policy matters.

This study argues that it was this clash of elected policymakers in Congress and the White House that brought CFIUS into existence in the first place and, when the conflict reignited during the 1980s, it redefined the scope and extent of CFIUS's authority and power in regulating foreign direct investment in the United States. This transformation in the makeup, mission, and authority of CFIUS in turn produced corresponding changes in the inward foreign direct investment policy of the United States.

Indeed, the creation CFIUS during the 1970s and the transformation of its power and authority during the late 1980s were driven by politics of structural choice. CFIUS's institutional evolution has been shaped by the interests, strategies, and compromises of the president and members of Congress. It was these elected policymakers who determined the amount and types of discretion granted to CFIUS in a manner consistent with their political interests and anticipated problems of overseeing delegated powers. CFIUS's origin, procedures, authority, and other institutional features reveal this truth about the dynamics of the U.S. inward foreign direct investment policy.

Summary

The argument presented here acknowledges the constraints the international system imposes on foreign policy choices of nation-states, but it places the burden of specific policy choice on elected politicians and the dynamics of the policymaking process. As the principal movers in the foreign economic policy arena, in the United States, the president and members of Congress are motivated to act on policy matters by what they perceive, conditioned by their respective positions in the institutions of government, as the national interest on one hand and their own political objectives on the other.

While it is important to acknowledge the importance of international incentives and constraints faced by nation-states, a deeper and more detailed knowledge of the foreign economic policymaking process is obtainable by thinking about the everyday politics of coping with the international system than to guess what is the prevailing balance of power in the global system or what a determined statesman in pursuit of the balance of power would attempt.[29] Despite powerful pulls and pushes of international constraints and incentives, in advanced industrial democracies, elected officials who hold ultimate power in day-to-day political life can still critically affect the direction and form of the national response to the international system.

Integrating the international and domestic level calculations of elected policymakers, this study-- though its attempt at synthesis does not achieve the elegance and parsimony of a formal model-- seeks to provide a useful, interpretive intellectual architecture necessary to advance the understanding

[29]Cowhey, *op. cit.*, p. 248.

of the U.S. inward foreign direct investment policy. The goal here is to develop an analytical framework employing the tools available to political science to understand a policy puzzle, a goal that is a step beyond the usual "description and prescription" found in a work of the "policy studies" genre.

Parameters

As for the parameters of the study, the analysis here concentrates on the *inward* foreign direct investment policy of the United States. Of course, it is reasonable to expect some discussion of the U.S. outward foreign direct investment policy. After all, an argument can be made that the postwar U.S. policy toward inward foreign direct investment has been largely driven by the outward foreign direct investment policy. After all, as the world's biggest and most active international investor in the period between the end of World War II to the early 1970s, the United States had self-interested reasons for keeping its own doors open.

However, upon closer examination, it is apparent that the two policies do not necessarily share the same processes, standards, or rules. Even prior to the recent restrictions on some incoming foreign direct investments, the fundamental difference has been obvious: The U.S. policy toward outward investment rejects the Calvo Doctrine which holds that a host nation has exclusive legal authority over all corporations in its domain; on the other hand, the U.S. policy toward inward investment embraces the Calvo doctrine in certain sectors of the domestic economy.[30]

Furthermore, this study restricts its analysis to policymaking at the federal level, though, as many point out, the federal government is not the only authority that regulates inward foreign direct investment in the United States. For example, many state and municipal governments have been very active in promoting inward foreign direct investment through various policy inducements. As far back as the nineteenth century, local authorities have looked upon direct investment, particularly the greenfield variety, as a political prize and have sought to attract it by championing their local workforce and infrastructure.

Yet, what is different and significant about the recent policy debate concerning inward foreign direct investment is the suspicion that foreigners are gaining unreciprocated access to vital domestic assets and surreptitiously obtaining taxpayer-funded technologies at the expense of United States' long-term economic health and military preparedness. Because of the importance of this security dimension of the issue, the study concentrates on the federal-level policymaking.

Clearly, there is an important local-level contribution to what amounts to the inward foreign direct investment policy of the United States, particularly in promoting the inflow of investments. However, the security issue that lies at the heart of the recent policy activism is a matter for the federal government. While national sovereignty concerns about inward

---

[30]See Horacio A. Grigera Naon, "Transnational Enterprises under the Pacto Andino and National Laws of Latin America," in Norbert Horn, ed., *Legal Problems of Codes of Conduct for Multinational Enterprises* (Kluwer-Deventer/The Netherlands: Studies in Transnational Law, 1980), p. 267.

foreign direct investment have been aired at the state and local levels, there have been only few, mostly ineffectual, efforts to restrict or place conditions on incoming investments by the local authorities.

With so many state and municipal governments engaged in fratricidal battles to attract foreign investors to their respective localities, it is difficult for them to enact and enforce a workable regulatory policy precisely because of the divided and competitive character of their promotional policies. The battle over the state unitary tax on foreign transnational corporations is indicative of this structural difficulty.[31] Even if local governments were to enact laws targeting investment activities by foreigners, in general, their ability to restrict or place conditions on foreign ownership would be severely constrained by the constitutional ban on the restriction of interstate commerce. Consequently, there is not much meaningful regulation of inward foreign direct investment at the state and municipal levels. Ultimately, only Washington has the authority and capability to effectively regulate inward foreign direct investment.

Organization of the Study

Beyond this introductory chapter, the study is organized into eleven additional chapters. The first four of these chapters are introductory in nature. Chapter Two coming up discusses the significance of the topic of this study and the study's contribution. Chapter Three examines some of the

---

[31]See "The 'Juicing' of California," Chapter 8 of Martin and Susan Tolchin's *Buying Into America: How Foreign Money is Changing the Face of Our Nation* (New York: Times Books), pp. 103-28.

most important mainstream approaches to analyzing foreign economic policymaking. Chapter Four assesses the utility of these approaches in explaining the dynamics of the U.S. inward foreign direct investment policy. Chapter Five advances the central theoretical argument of this study.

The substantive portion of this study is divided into six additional chapters. Chapter Six traces the history of foreign direct investment in the United States and the government policy toward it since the founding of the nation to the 1960s. This historical examination is important because inward foreign direct investment has played a vital role in the development of the U.S. economy from the earliest years of the republic, and the government regulation of it has an equally long history as well.

Chapters Seven, Eight, Nine, Ten, and Eleven discuss the reemergence of inward foreign direct investment as a controversial foreign economic policy issue in recent decades and examine the evolution of policy debates and outcomes. Chapters Seven and Eight concentrate on the events and policy developments of the 1970s when OPEC investments in the United States became a major political issue. Chapters Nine, Ten, and Eleven discuss the more recent emergence of the issue as a component of the politics of economic competitiveness.

Chapter Twelve concludes the study. It summarizes the findings and principal arguments of this study. It also indulges in some speculations about the future direction of the U.S. inward foreign direct investment policy.

CHAPTER TWO

Significance of the Study

Why is the subject of this study of any interest? Why should anyone care about it? There are a number reasons why the topic of the study and the analysis presented here may be of interest to scholars and policy specialists as well as to the general public.

First, the recent policy trend toward stricter scrutiny of foreign direct investment in the United States is not some epiphenomenal, insignificant exception to the historically liberal U.S. foreign economic policy. Given the tortuous rout of the recently completed Uruguay Round of GATT negotiations and the increasing movement toward managed trade and trading blocs, the trajectory of U.S. inward foreign direct investment policy is both a symptom of and a contributing factor in America's weakening commitment to costly global leadership.[1]

---

[1]The 1986 U.S.-Japan semiconductor agreement is emblematic of this weakening commitment. The bilateral agreement introduced measures to control so-called "dumping" of Japanese semiconductors in the United States and promised 20 percent share of the Japanese domestic semiconductor market for foreign suppliers. In addition, the United States has concluded with Canada and Mexico the North American Free Trade Agreement (Nafta), creating one of the largest regional trade blocks in the world. Some charge that the real motivation for Nafta was protectionism. For this view of Nafta, see Jagdish Bhagwati, "The Diminished Giant Syndrome: How Declinism Drives Trade Policy," *Foreign Policy*, Vol. 72, No. 2 (Spring 1993), pp. 22-6.

Second, there continues to be much public apprehension about the uncertainty of benefits and costs of Japanese investments in the United States.[2] The fear is rooted in Japan's rise as the new financial superpower sustained by its remarkable manufacturing prowess and increasing high-technology capabilities: As Japan's economic reach expanded in the 1980s while accumulating record trade surpluses, many in the United States began to feel anxious about Japanese aims and capabilities.

Japan, despite its recent economic and political problems, is now seen by some as the ambitious "number one-to-be" rather than the acquiescent junior partner once defeated in war. It is also seen by many as a fundamentally different kind of political economy that exploits the more liberal economies of the West. With many bitter ongoing economic disputes between the United States and Japan and the security relationship between the two fundamentally transformed by the collapse of the Soviet Union, the nature of Japanese investment activities in the United States will likely remain suspect to many, even if future investment levels do not match those of the 1980s. This continuing suspicion could further erode the already strained relationship.

Third, there is a relative poverty of works produced by political scientists on the subject of foreign direct investment in the United States. What rigorous scholarly works that exist on the topic are by economists who ignore political variables. While alarmist journalistic writings on the threat presented by "the Japanese invasion" are aplenty, there is a surprising lack of

[2]The level of apprehension is such that books and movies dealing with Japan's new influence in the United States have become "blockbuster hits" in recent years.

dispassionate studies that explore the complex politics of foreigners investing in the United States.

Finally, the exploration of the topic may expand the knowledge of "how," "why," and to "what effect" national governments pursue a particular course of action in international economic relations. Particularly, the scholarly debate on the formulation of foreign economic policy is a lively one, and this study engages some of the issues and controversies arising out of that debate.

Global Economy and American Interests

Until recently, regulations affecting the inflow of foreign investments from the non-communist world to the United States have not been the product of review of political and economic considerations in the evaluation of free versus restrictive investment policy. However, by the 1980s, America's dominance as the leading supplier of investments around the world had become reversed to the point where its prominence was now based on absorbing the lion share of world investment flows.[3] The extraordinary trade deficits of the 1980s and the accompanying shift of the United States from the world's largest creditor to its largest debtor focused America's attention on the problem of economic competitiveness as never before.

The immediate postwar aim of the U.S. foreign economic policy was the establishment of a liberal global economy. The United States emerged

---

[3]Though the drop in interest rates in the United States and the drying up of surplus capital worldwide have abated this trend, the magnitude of inflow of investments in the 1980s was unprecedented.

from World War II as the dominant economy in the world. Trade accounted for an insignificant percentage of the national income; and, with unchallengeable economic might, clear technological leadership, and no need of foreign capital, the United States was in command of its economic destiny. The U.S. national interest was best served by the free flow of trade and investments.

With the onset of the Cold War, however, the United States acquiesced to certain regional groupings, namely the European Economic Community, for their political value in countering international communism. Again, for the sake of containing communism, it made unbalanced trade concessions to its allies and friends in order to ensure their political stability and allegiance. Because of its overwhelming economic superiority, however, the United States could readily make these concessions to its allies.

In recent years, however, the end of the Cold War and the rise of economic nationalism attributable to the relative economic decline of the United States have weakened America's commitment to the liberal international economic order based on diffuse reciprocity in the form of unconditional most-favored-nation status. At the same time, the trend in the world economy toward managed trade and regional trading blocs has been accelerating, chipping away at multilateral arrangements such as GATT. Indeed, the outcome of the recent Uruguay Round talks was disappointing and the managed portion of the trade between Japan and the United States appears to be growing, though the jury is still out on the effect of the North American Free Trade Agreement (Nafta) and still inchoate regional entities such as Asia Pacific Economic Cooperation (APEC).

Of course, many argue that the U.S. commitment to the liberal economic order is fundamentally sound, but others see that larger systemic trends have already turned obsolete what some believe was a historic agreement between Congress and the White House underpinning the domestic basis of the political commitment to liberal multilateralism.[4] Indeed, in the trade policy arena, recidivism among uncompetitive domestic industries demanding relief has made it difficult for policymakers to shield themselves from chronic protectionist pressures.[5]

Moreover, in recent years, the some of the loudest calls for aggressive trade policy have come from the most competitive and innovative domestic industries-- for example, the supercomputer, semiconductor, commercial aircraft, and telecommunications equipment industries. Even if policymakers are not predisposed to old-style protectionism, they are now finding that it is difficult to resist these so-called "strategic trade policy" demands from leading-edge, high-technology industries.[6] This is not only because these firms employ large numbers of more educated voters whose political loyalty is considered contestable but because the demands have broad-based political appeal to an electorate worried about the national security and welfare implications of the declining competitiveness in high-technology industries.

---

[4]The historic agreement refers to the Reciprocal Trade Agreements Act of 1934, now an "obsolete bargain" which gave the president added trade powers in return for an implicit promise that the executive would protect members of Congress from the pressures of protection-seeking special interests. See David B. Yoffie's "American Trade Policy: An Obsolete Bargain?" in John E. Chubb and Paul E. Peterson, eds., *Can the Government Govern?* (Washington, D.C.: The Brookings Institution, 1989), pp. 100-138.

[5]One analyst argues that regulation of "unfair trade" has exploded not only because of new global competitive pressures, but because of the nature of American trade politics has created incentives to complain about and win protection against those pressures. See Pietro S. Nivola, *Regulating Unfair Trade* (Washington, D.C.: The Brookings Institution, 1993).

[6]At least according to a former Republican member of the House. Personal interview.

No doubt, as the world economy recovers, there will be the resumption of the multiplying and deepening linkages among national markets created by direct investment activities and the expansion of sales and purchases that these investments bring. However, because of the intimate link between trade and investment, the political tension generated by one will quickly spread to the other.[7] The animosity generated by trade conflicts will only increase the incentive for policymakers to take a more activist posture toward foreign direct investment.

Indeed, the recent movement toward tighter regulation of foreign direct investment in the United States is in many ways the flip side of the strategic trade policy coin and may foreshadow some form of often debated "industrial policy."[8] In a world of increasing economic integration *and* intensifying competition, the trend in the United States toward a tighter regulation of direct investments is a telling indicator of the increasing rift between U.S. commitment to the postwar vision of the liberal global economy on the one hand and more immediate national interests on the other.[9]

---

[7]To the extent large trade deficits continue to persist, foreigners cannot be expected to place all of their surplus capital in passive investments such as U.S. Treasury bills or in real-estate: and, as the trade imbalance stimulates protectionist measures, foreigners will invest in U.S. production facilities as a hedge against trade barriers that would exclude their products from American markets.

[8]One month after taking office, President Clinton, while campaigning for his economic package in Silicon Valley, unveiled a plan in which the government would explicitly back the development of commercially useful technology. This kind of "industrial policy" would involve making decision as to whether or not foreign firms can invest in a targeted domestic high-technology industry. For example, there are no foreign-owned firms included in Sematech, the consortium on computer chip-manufacturing technology that is financed half by industry and half by the Department of Defense to preserve a viable chip-making technology in the United States.

[9]The issue of inward foreign direct investment raises a more immediate question of "liberal interdependence" than that of outward foreign direct investment. In making policy toward

Fear and Loathing of Japan

When the issue of foreign direct investment in the United States is discussed as a national concern, the "foreign" in "foreign direct investment" is often a thinly disguised euphemism for "Japanese." This is true whether people discussing the issue are factory workers on launch-break or cognoscenti attending a catered policy workshop at some Washington think thank.

Misgivings about Japanese investments are rooted in American ambivalence toward the dramatic rise of Japan as a technological and financial superpower despite, or perhaps because of, the fact that Japan and the United States have grown highly interdependent economically. The enormous importance, yet the fragility, of this relationship makes Japanese direct investment in the United States a significant political issue even if the flow of investments from Japan does not match the levels seen during the late 1980s.

Though the pace of growth has slowed in the last couple of years, the flow of direct investments from Japan had been particularly rapid and highly conspicuous during the past ten years.[10] The speed with which the Japanese

---

incoming investment, a nation can adopt a policy consistent with those of other nations, or it can seek a policy course that is more domestic in focus that maximizes the short-term benefits of foreign direct investment to the domestic economy. The issue is also more intimately connected with the question of national autonomy-- hence, security-- in a world that is becoming more and more interdependent economically.

[10]The surge of investment began in earnest in 1983 and peaked in 1989. Economists have attributed the surge to the rise of the global economy, a drop in the U.S. savings rate, changes in U.S. tax laws, and the attractiveness of the U.S. market. The slowing of investment flows in recent years is largely due to the downturn of economic conditions in the United States as well as Japan. In absolute terms, Japan still lags the United Kingdom which is still the largest single investor in the United States. As of the end of 1991, Britain's investments in the United States were valued at $106.1 billion, followed by Japan at $86.7 billion, the Netherlands at $63.8 billion, Canada at $30 billion, Germany at $28.2 billion, and France at $22.7 billion.

have increased their holdings in the United States is underscored by their purchase of some of the most visible American assets.[11] Since mergers and acquisitions, rather than "greenfield" investments, have been the more dominant forms of Japanese investments, many in the United States have expressed the concern that the Japanese are not creating new jobs or enhancing growth in the domestic economy but, rather, they are "hollowing out" American industries and helping themselves to U.S. taxpayer-funded technologies.[12] In fact, some have questioned whether that the Japanese may have been intentionally targeting vulnerable emerging or capital-starved high-technology companies with their investments.[13]

In terms of their political impact, these concerns about Japanese investments are not intelligible without understanding the atmosphere of tension between the United States and Japan caused by the large and persistent Japanese trade surplus with the United States. Indeed, there is more to the anxiety about Japanese investments than the racism some see in the American obsession with Japanese purchases versus the lack of interest in investments made by Europeans. Trade has been a source contention since

---

Japan is a late comer to investment in the United States, making the sudden surge of its investment during the mid and late 1980s (when it surpassed Dutch and Canadian investments) that much more noticeable. Organization for International Investment, "Foreign Investment in the U.S.: A Fact Guide," Washington, D.C., February 1993, p. 8.

[11]For example, the Japanese have purchased such quintessentially American companies as Columbia Pictures, MCA, and CBS Records.

[12]See John Zysman's "Contribution or Crisis: Japanese Foreign Direct Investment in the United States," in Kozo Yamamura, ed., *Japanese Investment in the United States: Should we be concerned?* (Seattle: Society for Japanese Studies, 1989), pp. 97-110.

[13]For example, Linda Spencer in "Foreign Investment in the United States: Unencumbered Access," Washington, D.C., Economic Strategy Institute, May 1991.

the late 1960s, but, by the late 1980s, the bilateral trade disputes have turned downright acrimonious.[14]

Two decades ago, the United States and Japan were quarreling over textile trade, a matter of no real importance to the economy of either. While old-style issues involving consumer goods exports have not disappeared, today, the sources of conflict between the two countries involve commercial disputes in leading-edge, high-technology sectors crucial to the economic future of both and huge international investment flows on which each is highly dependent. These thornier issues of technology-related trade and investment have now led to incessant bickering about the more fundamental macroeconomic and structural issues of the trans-Pacific relationship.[15]

And as the number, diversity, and scope of bilateral conflicts continue to grow, so does their political difficulty. Recent public opinion surveys reveal rising levels of tension in both countries. For example, by the late 1980s, the level of bitterness generated by commercial conflicts has reached the point where the majority of Americans polled in a survey felt that "the economic power of Japan" to be a "greater threat to the United States these days" than "the military power of the Soviet Union" and overwhelmingly saw Japan as America's "strongest competitor."[16]

---

[14]Japan and the United States have been negotiating over trade related issues since the late 1960s. In hindsight, it is ironic that America's 1.2 billion dollar trade deficit with Japan in 1970 sent panic through Washington. For a good account of this, see I. M. Destler, Haruhiro Fukui, and Hideo Sato, *The Textile Wrangle: Conflict in Japanese-American Relations, 1969-1971* (Ithaca: Cornell University Press, 1979), especially pp. 292-3.

[15]I. M Destler and Michael Nacht, "Beyond Mutual Recrimination: Building a Solid U.S.-Japan Relationship in the 1990s," *International Security*, Vol. 15, No. 3 (Winter 1990/91), pp. 92-119.

[16]See "Japan Survey," for The New York Times/CBS News/Tokyo Broadcasting System, June 5-8, 1990 (U.S.) and May 31, June 7, 1990 (Japan); results summarized in *New York Times*, July 10, 1990.

The bilateral relationship has deteriorated to the point that many in the United States have now abandoned the long-held view that Japan, though an annoying free-rider in the liberal global trading system, is a valuable ally for the revisionist view that Japan is a potentially dangerous "developmental state" that practices "adversarial trade." The revisionists point to the fact that, despite the steep decline in the value of the dollar since the mid 1980s and the subsequent recalibration of the terms of trade with the European trading partners, high levels of trade deficit still persist with Japan. They argue that this is because mercantilistic Japan maintains "structural barriers" to fair trade.[17] Recent rancorous rounds of bilateral trade talks have been based on this revisionist view that Japanese trade and investment barriers include deeply rooted particularistic business practices and customs as well as explicit government policies. The recent Structural Impediment Initiative (SII) is indicative of the increasing influence of the revisionist view on U.S. policy toward Japan.

Pointing out that Japan's pivotal role in America's anti-communist strategy in Asia during the Cold War is now history, the revisionists argue that the United States should stop the futile attempt to change Japan's mercantilistic behavior and begin to "contain" its economic expansion.[18] Indeed, for most of the period since World War II, the central pillar of the U.S.-Japan relationship was the American guarantee of Japan's security in

---

[17]See the discussion on structural barriers to trade in Clyde V. Prestowitz, *Trading Places: How We Allowed Japan to Take the Lead* (New York: Basic Books, 1988), particularly, pp. 151-84. Examine also Karel van Wolferen, *The Enigma of Japanese Power: People and Politics in a Stateless Nation* (London: Macmillan, 1989), and James Fallows, "Playing by Different Rules," *Atlantic Monthly*, September 1987, pp. 22-32.

[18]See James Fallows, "Containing Japan," *Atlantic Monthly*, May 1989, pp. 40-54. Also Charlmers Johnson, "Their Behavior, Our Policy," *The National Interest*, No. 17 (Fall 1989), pp. 17-27.

return for access to Japanese territory as the linchpin of the U.S. strategic posture in Asia. For a long time, it was an exchange that served each country well. Japan, which perceived a real threat from the Soviet Union, was able to focus its energy on economic modernization while the United States could count on Japan as a wealthy anti-communist ally. With the collapse of the Soviet Union, however, many argue that this "grand bargain" has been made virtually obsolete.[19]

With the changed world strategic situation and the reassessment of the bilateral relationship taking place on both sides of the Pacific, "reciprocity" has become an important operating concept in the U.S. approach to bilateral trade problems. Not surprisingly, the concept has also entered the controversy concerning Japanese direct investment in the United States. After all, there is about four times as much Japanese direct investment in the United States as American investment in Japan, and with only one percent of its national income generated by foreign-owned enterprises, Japan's receptivity toward foreign direct investment diverges sharply from those of other OECD countries.[20]

Of course, a good deal of the increase in Japanese investments in the United States can be attributable to the Japanese, as well as U.S., attempt to offset the trade imbalance. However, one recent study shows that the lopsidedness between the outward and inward investment in Japan is of the order of 33 to 1 (cumulated 1980-88). This is a remarkable figure given that

---

[19]Stephen W. Bosworth, "The U.S. and Asia in 1992: A New Balance," *Asian Survey*, Vol. 33, No. 1 (January 1993), p. 110.

[20]Data derived from the U.S. Department of Commerce, *U.S. FDI: 1988 Annual Survey* (Washington, D.C.: Government Printing Office, 1988). For an excellent discussion of the asymmetries in the U.S.-Japan direct investment, see Dennis J. Encarnation, *Rivals Beyond Trade: America versus Japan in Global Competition* (Ithaca: Cornell University Press, 1992).

the comparable ratio for Germany is 6 to 1, for France, 1.5 to 1, and for Britain, 2 to 1.[21] Some argue that this is because the Japanese have made the control of foreign transnational corporations a central objective of both government policies and private business practices in order to prevent foreigners from pursuing in Japan crucial investment strategies that are now central to international competition.[22] Although there is very little left of the formal government discrimination against foreign direct investment in Japan, because of informal private business practices of the Japanese, many argue that persistent asymmetries between Japan and other countries of the OECD remain.[23]

Clearly, what was once a relatively simple and limited trade rivalry between steadfast allies is now a fierce global competition involving leading-edge industries of the two nations complicated by many thorny realities of interdependence of which the intensifying international investment activities of transnational corporations are but one. The dynamics of the U.S. inward foreign direct investment policy in recent years is, hence, inseparable from the power structure underlaying the trans-Pacific relationship.

Samuel Huntington observes, "the United States is obsessed with Japan for the same reasons that it was once obsessed with the Soviet Union."[24] That is, the United States now sees Japan as a challenger to its primacy in a

---

[21] Ratios derived from data presented in the Appendix of Julius, *Global Companies and Public Policy*, pp. 114-22.

[22] Encarnation, *op. cit.*

[23] This apparent lack of reciprocity was vividly dramatized by T. Boone Pickens' unsuccessful attempt to takeover the Japanese firm of Koito, a member firm of the Toyota *keiretsu*.

[24] Samuel Huntington, "America's Changing Strategic Interests," *Survival*, Vol. 23, No. 1 (January/February 1991), p. 8.

crucial arena of power. If this is the case, it is likely that the issue of inward foreign direct investment will continue to attract political attention because there would be less and less reasons for the United States to indulge what it sees as the economic misdemeanors of Japan in the interests of greatly diminished security objectives while its fears of Japanese high-technology economic dominance would grow more and more.

Poverty of Literature

The massive upsurge of foreign, particularly Japanese, direct investment in the United States in recent years has caught the attention of many opinion-makers, unleashing a flood of sensationalistic journalistic works that sound the alarmist bell on the dangers of Japanese purchase of U.S. assets.[25] These writings warn that Japanese are trying to "buy up America" at fire-sale prices and exert undue political influence. They also warn that Japanese direct investment may suppress technological innovation in America, deepen the trade deficit, and endanger the livelihood of America workers.

Economists have joined in with their more measured and balanced contributions. Of course, there exists already a significant body of theoretical works by economists on foreign direct investment. However, more topical

---

[25]For example: Daniel Burstein, *Yen! Japan's New Financial Empire and Its Threat to America* (New York: Fawcett Columbine, 1988); Douglas Frantz and Catherine Collins, *Selling Out: How we are letting Japan buy our land, our industries, our financial institutions, and our future* (Chicago: Contemporary Books, 1989); and Tolchin, *Buying Into America.*

and policy-oriented works have appeared recently in reaction to the upsurge of investments in the United States during the 1980s.[26]

These works by journalists and economists, however, do not provide much needed examination of the *politics* of foreign direct investment policy in the United States. Economists writing on the subject generally avoid political analysis. And journalists tend to be preoccupied with advocating their pet policy prescriptions to what they invariably perceive as "the takeover threat."

Despite the increasingly important role of foreign direct investment in international commerce and the heightened political sensitivity toward Japanese investments in the United States, there is a dearth of works by political scientists on the subject. Of what little there is, they tend to be non-theoretical "policy studies" with normative and prescriptive content.[27] Of course, there exists a substantial body of research on the politics of outward foreign direct investment flowing from the developed to developing nations, as well as the impact of such investment on host countries. In fact, during the 1970s, the research effort along the North-South axis constituted something of a growth industry.[28]

---

[26]One of the most informative and balanced works is Edward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics, 1989).

[27]See Robert T. Kudrle, "Good for the gander? foreign direct investment in the United States," *International Organization*, Vol. 45, No. 3 (Summer 1991), pp. 397-424. More theoretical is Simon Reich's informative comparative study, "Roads to follow: regulating direct foreign investment," *International Organization*, Vol. 43, No. 4 (Autumn 1989), pp. 543-83.

[28]For a state-centered, realist view of the North-South dimension of foreign direct investment, see Robert Gilpin's *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment* (New York: Basic Books, 1975). See also Krasner, *Defending the National Interest.*. Typical among those concentrating on the power of transnational corporations from a liberal institutionalist point of view is Raymond Vernon's *Sovereignty at Bay* (New York: Basic Books, 1971). Less enthusiastic is Richard J. Barnet and Ronald E.

On the politics of foreign direct investment within the developed world, however, not much rigorous work has been done though there is a body of works-- much like the present-day "Japan bashing" literature-- produced in Europe during the 1960s decrying American investment activities in Europe. While the quality of this body of works is uneven, its themes have much resonance today because, for example, it is unlikely that the United States would accept a turnabout of condition as fair play with equanimity if the kind of political interference denounced by the Europeans were directed against U.S. national interests in the 1990s.[29]

When the level of American investments was reaching new heights in Europe during the late 1960s, many Europeans voiced their fears that American investors exercised excessive external management control of their subsidiaries and branches operating in Europe and that such control was often exercised in ways inimical to European interests.[30] Indeed, there were a number of well documented cases of U.S. government constraints on subsidiaries of U.S. companies in Europe that provided a channel for U.S. influence on the policies of European nations.

Muller's *Global Reach* (New York: Simon & Schuster, 1974). Finally, the so-called "dependency" literature is vast: Some typical statements can be found in Samir Amin, *Unequal Development* (London: Monthly Review Press, 1976); Fernando H. Cadoso and Enzo Faletto, *Dependency and Development in Latin America* (Berkeley: University of California Press, 1979); and Andre Gunder Frank, *On Capitalist Underdevelopment* (Bombay: Oxford University Press, 1975).

[29]See Thomas N. Gladwin and Ingo Walter, *Multinationals Under Fire* (New York: Wiley, 1980).

[30]Nowhere in the developed world have American investments provoked more reaction, or encountered a cooler reception, than in France during this period. French policymakers and opinion-makers averred that certain key sectors of their economy were either already under foreign (*viz.*, American) control, or in imminent danger of falling prey to it, and that this tends to remove an industry or, indeed, an entire sector of the economy from the reaches of their national economic planning mechanism. See the English translation of Jean-Jacques Servan-Schreiber's *Le Défi Américain-- The American Challenge* (New York: Atheneum, 1968).

In recent years, many in the United States have voiced the same kinds of concerns about technological gaps and the loss of sovereignty the Europeans fretted about during the 1960s. These intrinsically political themes and concerns claimed by journalists need to be reexamined in a more objective manner using the analytical tools available to political science.

Formulation of Foreign Economic Policy

Finally, this study engages the endeavors of those scholars studying the international political economy, particularly those specializing in the formulation of foreign economic policy. Though there is a substantial body of scholarly works on foreign economic policymaking, there are many significant unanswered questions about the numerous ways nation-states act in order to affect the international economic environment either directly or by adjusting the way they relate to it. Questions as fundamental as the level of analysis and the power structures alleged to govern the formation of policy are still in dispute. For instance, does the international environment determine policy, or the domestic political condition? If one or the other or both, then, how? Who makes policy? Who determines its content and direction? Does the executive have greater say over policy, or the legislature? What about interest groups in society?

Furthermore, there are basic analytical methods still at issue in the contemporary scholarly debate, and the present study of the U.S. inward foreign direct investment policy, with its particular analytical approach, may add something new to the discussion. Of course, some may criticize the preoccupation with U.S. foreign economic policy behavior among those studying the international political economy. However, the focus on the United States is not simply due to myopia or laziness because, despite its relative economic decline, the United States remains the most powerful actor in the world economy and the foreign economic policy it selects continues to have profound consequences for the rest of the world.

From a more substantive point of view, though relatively unappreciated and neglected in the study of economic relations among developed countries, the policy toward inward foreign direct investment merits particular attention because it explicitly intertwines economic considerations with national security interests in dealing with trading partners. More so than trade or monetary policy, inward foreign direct investment policy intimately links the politics of prosperity and power. After all, direct investment constitutes a more immediate, tangible form of foreign influence. Given the various long-standing arguments among analysts about the interaction between commerce and national power, the study here could shed new light on these old controversies.

Finally, this study is another small step toward gaining a deeper understanding of government institutions and political processes. In the course of its analysis of the politics of U.S. inward foreign direct investment policy, the study implicitly raises and attempts to answer some fundamental questions in the study of politics: Who governs? How do they govern? What are the results of their stewardship? This study is not only an attempt at acquiring a more refined understanding of specific foreign economic policy problems and their lessons, but it is also an examination of the practical operation of politics-- the interaction of government officials and institutions, interest groups, public opinions, various international forces, and other significant agents and factors.

CHAPTER THREE

Existing Approaches

What factors account for the recent shift in and the shape of U.S. policy toward inward foreign direct investment? The scholarly interest in the mysteries of foreign economic policymaking is such that there is no shortage of analytical tools available to address the question. This chapter is the first of two chapters that surveys the literature on foreign economic policymaking in advanced industrial societies. The present chapter identifies some of the leading analytical tools while the next chapter evaluates them for their utility in answering the question at hand.

Plethora of Theories

In analyzing foreign economic policy behaviors of modern nation-states, observers of international economics and politics have employed numerous theories that purport to explain the sources and purpose of policy. Since multiple factors tend to influence these behaviors, the outcome has been multiplication of theories. And, of course, the abundance of theories has in turn led to the proliferation of analytical approaches that, some argue, only confuses and obscures. Nonetheless, a search through the literature would yield a number of approaches that may be of help in analyzing the dynamics of U.S. inward foreign direct investment policy.

First, there is the economic approach. Until very recently, informed discussions on the subject of foreign direct investment in the United States have been largely led by economists. Hence, any survey of analytical tools available cannot ignore the economic approach. However, more useful to the purpose of this study are approaches developed by political scientists.[1]

A quick survey of the mainstream political science research on the international political economy and the formulation of foreign economic policy would reveal that there are broadly two types of approaches that are common in the literature. The first type is systemic, the other, national. Foremost among the systemic approaches are the liberal institutionalist and neomercantilist ones with their respective variants. Among the national approaches, a myriad of society-centered and government-centered ones exists.[2]

What follows is a brief description of some of the most often encountered analytical approaches in the mainstream literature that may be of use in explaining the dynamics of the U.S. inward foreign direct

---

[1]While it true that, compared to other topics concerning the United States and the world economy, political scientists have paid relatively little attention to the phenomenon of foreign direct investment in the United States. Fortunately, there is no shortage of analytical approaches utilized in analyzing trade and monetary politics that cannot be appropriated for the study of the politics of foreign direct investment in the United States.

[2]Apart from these two types, there are others that focus narrowly on policymakers themselves or ideas or a combination of both. For example, one group of works focuses on the beliefs and cognition of top leaders. While persuasively applied to other forms of foreign policy, these approaches have enjoyed relatively limited application in the study of foreign economic policy, although in new guises they are making inroads into the study of international political economy.

investment policy. Of course, there are other approaches, as well as variations and subtleties within the approaches examined, that would be worthy of consideration in a more comprehensive assessment of the literature. However, the survey here is limited by space to those approaches, grouped into a few broad types, with a wide following as an active "research program" among those studying the formulation of foreign economic policy.[3]

Economic Approach

Before turning to how political scientists might address the questions posed in this study, it is worthwhile to examine first how economists view the changing U.S. inward foreign direct investment policy. This is not an unwarranted digression because neoclassical economics underlies some of the political approaches discussed below, and the fact cannot be ignored that economists often dominate the policy discourse concerning foreign direct investment in the United States, something not very surprising given that the language of neoclassical economics is the *lingua franca* of government policy circles as well as international investors.[4]

To be sure, economists tend to be interested in economic matters, not in political ones. Concerning the recent surge of foreign direct investment in the United States, they are first and foremost interested in the market reasons for the rise and consequences of the inflow of foreign capital; secondly, what

---

[3]On the definition of "research program" see Imre Lakatos, *The methodology of scientific research programmes: Philosophical Papers Volume 1* (Cambridge: Cambridge University Press, 1978), p. 4.

[4]Although the contributions of journalists are not inconsequential to the policy debate concerning foreign direct investment, they tend to be less balanced, not to mention harder to categorize since their viewpoints tend to be wide-ranging and eclectic.

to do (or, more often, not to do) about it; and, thirdly, if at all, what drives the policy toward it.

Nonetheless, implicit in their preoccupation with market factors is the neoclassical rationale for expecting government policy in the direction of *laissez-faire*.[5] Reflecting the bias of their profession, economists implicitly expect market conditions to drive policy. In policy discussions, they argue that it is only rational that the United States should maintain an open policy toward foreign direct investment because open borders maximize welfare. For those trained in the neoclassical orthodoxy, utility is defined in terms of economic welfare (meaning, the goods and services available for final consumption) to the general exclusion of other possible values or ends.[6] Hence, it is only logical to assume that rational governments seek, as would any consumer, to maximize "real economic welfare."[7]

As with government's domestic goals, economists see the end of government's international economic policies as the maximization of society's economic growth and efficiency. They have long championed that

---

[5]Some argue that there is no such thing as a liberal theory of political economy because liberalism separates economic and politics from one another and assumes that each sphere operates according to particular rules and a logic of its own. However, this view is itself, as Gilpin points out, an ideological position and liberal economists do in fact concern themselves with both political and economic affairs. Whether it is made explicit in their writings or is merely implicit, one can speak of a liberal economic theory of political economy.

[6]To those who speak the neoclassical language, the primary interest of a government is, or should be, the pursuit of policies that seek the greatest possible income for its society. The neoclassical economic approach starts from the philosophical premise that the individual is analytically and normatively fundamental, and it assumes that society is, in effect, an aggregate or an outcome of the pursuit of individual interests and politics is likewise just an agency through which individual interests are realized.

[7]The typical policy position taken by mainstream economists is exemplified by "Is America Being Sold Out?" authored by Mack Ott of the Federal Reserve Bank of St. Louis, excerpted in Jeffry A. Frieden and David A. Lake, ed., *International Political Economy: Perspectives on Global Power and Wealth*, 2nd Ed. (New York: St. Martin's Press, Inc., 1991), pp. 220-9.

the basic value determining a nation's foreign economic policy should be the optimal allocation of resources for national growth in the context of a global economy that operates in accordance with liberal economic norms. They argue that global, as well as national, economic efficiency requires that all nations specialize in the production of those goods in which they possess a comparative advantage and allow unfettered trade of goods and movement of capital.[8] To the extent that government policies conform to these requirements, all nations' economic growth will be maximized.

Underlying economists' optimistic view of the international political economy is the assumption that there are no major conflicts of interests among nations in a liberal world system. Neoclassical economics assumes a world composed of fully autonomous nations enjoying equal economic opportunity-- though not equal economic condition-- in an open international system. It also assumes that all nations enjoy full freedom in making important choices concerning their domestic and foreign economic policies.[9] These assumptions in turn lead economists to argue that the liberal rules of behavior in international economic relations, the policies of the international organizations enforcing these rules, and the role played by transnational actors such as multinational banks and business enterprises are positive and politically neutral.

In practice, of course, the reality intrudes, and many economists accept the condition that, to the extent that market mechanisms generate socially

---

[8]Of course, there are economists who challenge the notion of comparative advantage as a dated concept. See Michael E. Porter, "The Competitive Advantage of Nations, " *Harvard Business Review*, March-April 1990, pp. 73-93.

[9]Hence, many orthodox economists do not differentiate policies appropriate for different nations in different economic and political situations.

unacceptable inequalities and negative externalities, governments may address them through non-market remedial measures. Nonetheless, they argue that governments should be wary of intruding on the workings of the market, for the market is the key to efficiency in all economic transactions.

Hence, with regard to the realities of the international political economy, even if the distribution of benefits among the nations of the world is not symmetrical, economists see the prevailing market-conforming relationships among nations as promoting Pareto optimality, therefore, beneficent by definition. To the extent that national policies do not enhance efficient allocation of resources, they blame the failure to pursue rational market-oriented policies by governments. Indeed, the policy implications of the so-called "strategic trade theory" which focuses on the consequences of monopolistic elements in international markets have been vigorously contested within mainstream economics because of the profession's strong normative leaning toward efficiency and absolute gain, not just because many have found the new theory not very robust.[10]

---

[10]Relaxing the strict parameters of the neoclassical trade theory, "strategic trade" theorists focus on trade under imperfect competition. While there are variations within this new line of research, there is agreement on the point that free trade is not always optimal and that protectionist policies by governments can increase national income by raising the profitability of domestic firms in certain imperfect markets. Though these theories have caused much excitement in recent years, a more sober assessment is now taking hold. Critics charge that the new theories are partial and underdeveloped to serve as a basis for policy, arguing that they may convincingly argue that a government, under certain conditions, can improve national welfare by "shifting profits" from foreign to domestic firms but this can leave every country worse off under real-world conditions. For more on "new international economics," see the following: Paul R. Krugman, "New Theories of Trade Among Industrial Countries," *American Economic Review*, Vol. 73 (May 1983), pp. 343-7; and Gene M. Grossman and J. David Richardson, *Strategic Trade Policy: A Survey of Issues and Early Analysis*, Special Papers in International Economics, No. 15 (Princeton: International Finance Section, 1985).

System Level Approaches

Among the common analytical approaches employed by political scientists, systemic ones attribute foreign economic policy outcomes to the incentives and constraints created by the structure of international relations. Broadly, there are two kinds of system-level analyses that dominate the mainstream political science literature on the international political economy. One may be labeled "liberal institutionalist," the other, "neomercantilist." Both emphasize the structural characteristics of the international political economy because they supposedly generate enduring and powerful influence on nation-states and, consequently, on their respective foreign economic policy behavior.

Liberal Institutionalism

Liberal institutionalists, to one degree or another, embrace the neoclassical economic notion that the benefits of international division of labor based on the principle of comparative advantage cause markets to arise and foster harmony among states. From this liberal foundation, they assert the existence of international interdependence that conditions the actions of individual nation-states. They hold that the expanding web of economic interdependence creates a basis for peace and cooperation among nations. They cite as evidence the great postwar expansion of international commerce, which they attribute to the institutional legacies of the Bretton Woods agreement inspired by neoclassical principles, and the triumph of the capitalist West over autarkical communism.

Liberal institutionalism is a modern response to the traditional balance of power view of international relations, and it has manifested itself in three successive presentations in the postwar period: the functionalist integration theory in the 1940s and early 1950s, the neofunctionalist regional integration theory in the 1950s, and the interdependence theory in the 1970s to the present.[11] In all three guises, liberal institutionalists have consistently contested the view of world politics as anarchy tempered by war and diplomacy.

One of the most characteristic liberal institutionalist positions is that the traditional primacy accorded to states in international relations is overrated. For the functionalists, the central actors in the world system were not national governments but specialized international organizations and their technical experts; for the neofunctionalists, they were labor unions, political parties, trade groups, and other organizations; and for the interdependence school, among others, they are international organizations, trans-governmental coalitions, and transnational corporations.

Liberal institutionalists reject the treatment of states as unitary agents. The functionalists argued earlier that authority was already decentralized within modern nation-states and it was undergoing a comparable process internationally. Similarly, modern governments, according to contemporary

---

[11]For functional internationalism, see David Mitrany's *A Working Peace System* (Chicago: Quadrangle, 1966). For neofunctionalist regional integration theory, see Ernst B. Hass, *The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957* (Stanford: Stanford University Press, 1958). See also Joseph S. Nye, Jr., "Comparing Common Markets: A Revised Neo-Functional Model," in Leon N. Lindberg and Stuart A. Scheingold, eds., *Regional Integration: Theory and Research* (Cambridge: Harvard University Press, 1971), pp. 192-231. For interdependence theory, see Robert O. Keohane and Joseph S. Nye's *Power and Interdependence: World Politics in Transition* (Boston: Little, Brown, 1977). A summary of this progression of liberal institutionalist theories is found in Joseph M. Grieco's *Cooperation among Nations: Europe, America, and Non-tariff Barriers to Trade* (Ithaca: Cornell University Press, 1990), pp. 4-6.

interdependence theorists, are increasingly characterized by "multiple channels of access," which in turn progressively weaken the grip on foreign policy previously held by government officials. They point to the various ways powerful multinational or supranational organizations act outside of the control of national governments as evidence of this reality.[12] They argue that nation-states are now linked in numerous ways and a corresponding multiplicity of interests has developed, many of them outside the apparatus of national government.

Many liberal institutionalists also argue that nations are becoming less concerned about power and security. They reject as no longer relevant the view that nations are fundamentally competitive and mutually suspicious of each other, finding instead that nations increasingly view one another not as potential enemies but as partners needed to provide greater welfare for their citizens. They point out that the vast destructive power of nuclear weapons and readily mobilized national populations have rendered modern warfare prohibitively expensive. Moreover, they observe that the increasing international economic ties are driving nations to be progressively dependent on one another for the attainment of such national goals as faster economic growth, full employment, and price stability.

Recently, however, there has been some degree of accommodation between liberal institutionalism and the traditional balance of power view of world politics. Some liberal institutionalists now accept to a greater degree the realist position that states are the central actors in world politics and that the absence of central authority profoundly inhibits the willingness of nations

[12]See Vernon's *Sovereignty at Bay*. With Japan ascendent, there is a new twist to Vernon's ideas in Kenichi Ohmae's *The Borderless World,: Power and Strategy in the Interlinked Economy* (New York, Harper Business/HarperCollins Publishers, 1990).

to cooperate with one another.[13] With the mounting evidence that the postwar system of international cooperation may be more fragile than many had hoped for and expected, some liberal institutionalists now concede that states, as rationally egoistic agents, find it hard to work together in the face of anarchy because cheating is both feasible and profitable. Nonetheless, they assert that international "regimes" can increase the incentive for cooperation and reduce cheating because regimes facilitate the pursuit by states of a strategy of reciprocity that reduces the uncertainties they otherwise may have about the faithfulness of partners.[14]

The way this system of reciprocity is seen to be working are diverse.[15] A wide range of views exists between the more Grotian liberal institutionalists on the one end and the more structural-realist leaning ones on the other. Some claim that regimes operate through the externalization of norms that promote trade and investment but also minimize their domestic costs and hence protectionist demands. Others suggest that regimes and their norms are eventually embodied in domestic policies and practices, that is, they constrain and shape domestic rules and behaviors. Still others see regimes as directly encouraging international commerce itself by increasing efficiency. Significant differences thus exist over exactly how regimes and international organizations supposedly abate nationalist pressures, but

---

[13]Grieco, *op. cit.*, particularly pp. 9-11.

[14]Regimes have been described as sets of international principles, norms rules, and decision-making procedures around which nations expectations converge in a given issue area in international relations.

[15]A sampling of the issues and concerns of the literature on regimes can be found in Stephen D. Krasner, ed., *International Regimes* (Ithaca: Cornell University Press, 1983).

generally they are seen as exerting a brake on pressures for restrictions on international commerce and limiting states' incentive to cheat.

Neomercantilism

Drawing on the balance of power tradition in the study of international relations, neomercantilist approaches provide a state-centered, if highly schematic, explanation of the international political economy. They see a world of rational, self-seeking states where these states function in an environment that is defined by their own interests, capabilities, and interaction.

Neomercantilism is rooted in the philosophical tradition that views society as an organism, the interests of which are necessarily higher than those of any individual.[16] In its present-day manifestation, it is closely allied with structural-realism in stressing the subordination of economic forces to political interests and in emphasizing the primacy of national interest. Neomercantilists envisage a world not of markets but of states, a world in which economic policy is a weapon in the never ending struggle for security.

Neomercantilists argue that states are fundamentally concerned about their political independence, while this independence results from and depends upon their own efforts. Hence, states are preoccupied with what the effect will be of nearly any relationship-- be it military, economic, etc.-- on their relative defensive capabilities. States worry that others may make

[16]This corporatist tradition usually portrays the individual as deriving his or her identity and purpose from the larger society, which inevitably becomes synonymous with "the state." In Germany, figures such as Fichte and List followed Hegel in arguing that the individual realizes his or her identity and freedom through the state. They rejected the individualist and materialist assumptions of Anglo-Saxon liberalism and utilitarianism and stressed the need to ground economic theory and policy in the larger interest of the nation.

comparatively larger gains, concerned at the extreme that a present ally may turn out to be a future foe; thus states fear that mutual gains that advantage a partner now might produce a more dangerous potential adversary latter.[17]

Neomercantilism's preoccupation with national security has implications for economic activity that are, at times, diametrically opposed to those of neoclassical economics and liberal institutionalism. After all, neomercantilists contest some of the most important assumptions and values of neoclassical economics and liberal institutionalism. Given their disregard for the importance of absolute gains, they are particularly skeptical about the benefits of *laissez-faire* economics.[18] And, in contrast to liberal institutionalists, they are suspicious of transnational actors and supranational organizations. Instead of harmony and efficiency, they stress conflict and power with regard to the role of international organizations.

For neomercantilists, what is significant about transnational actors in the global economy are the political circumstances that enable them to play their respective part in international relations. That is, the primary determinant of the role played by non-state actors is the larger configuration of power among nations.[19]

---

[17]Grieco, *op. cit.*, especially Chapter One.

[18]Some neomercantilists would argue that, as a practical matter, free trade does not mean truly free economic exchange across national borders but, in fact, rule-bound trade (e.g., GATT).

[19]While liberal institutionalists believe that GATT rules reflect the economic theory of the free market and that these rules create conditions approaching the efficiency of an unfettered market, neomercantilists argue that, while GATT caused a lowering of tariff barriers to trade, the explosive postwar economic growth occurred chiefly because of the national objectives of the United States: The United States, in order to maintain global security and curb the spread of communism, threw open its markets to its allies in Western Europe and Japan while tolerating these countries' domestic protectionism against American products. Neomercantilists would argue that GATT rules only camouflaged this power structure underpinning the postwar system of international economic relations. They would add that GATT is in trouble today because the unique strength of the American economy during postwar reconstruction has

Obviously, neomercantilists place power and politics over wealth and economics in both the explanatory and prescriptive spheres. Nonetheless, the "downright" tone of this realist approach sometimes conceals a subtler, more sophisticated treatment of power and wealth.

Some neomercantilists argue that the economic motive and commercial activities are fundamental to the struggle for power among nations, so any opposition of "political interests" and "economic interests" distorts reality: They posit a reciprocal relationship between power and wealth.[20] They argue that, in the short run, the distribution of power among nation-states and the nature of the international political system are the major determinants of the framework within which wealth is produced and distributed; however, in the long run, the shifts in economic efficiency and the location of economic activity tend to undermine and transform the existing international political system. This political transformation in turn gives rise to changes in international economic relations that reflect the interests of the ascendant state in the system.[21]

National-level Approaches

Moving on to national-level approaches, there are broadly two types of approaches in the mainstream political science literature on the formulation

---

dissipated, and yet the legacy of protectionism among the postwar beneficiaries of the GATT system blocks development of new markets.

[20]Gilpin, *U.S. Power and the Multinational Corporation*, p. 21. See also his *War and Change in International Politics* (Cambridge: Cambridge University Press, 1981).

[21]Hence, stability and change in the international political economy are explained by the distribution of power in the world system. See Gilpin, *op. cit.*, and Stephen Krasner, "State Power and the Structure of International Trade," *World Politics*, Vol. 28 (April 1976), pp. 317-47.

of foreign economic policy in advanced industrial democracies. One is society-centered, the other, state-centered. There is a great deal of variation and difference among approaches of each type, but what follows is a brief review of the most notable ways the foreign economic policymaking process has been studied by analysts employing national-level approaches.

Society-Centered Approaches

Most mainstream society-centered approaches have their basis in some sort of a behavioral view of politics. They tend to see politics as arising out of society and do not sharply differentiate the institutions of government from the rest of society. They assume that political phenomena are the aggregate consequences of individual behavior and political action resulting from calculated self-interest. They make a direct connection between the expected utility and outcome with minimal intervening question of uncertainty.

Prominent among society-centered approaches, particularly as they have been applied in the study of U.S. foreign economic policy, is what may be described as the interest group approach. This approach stresses the ongoing struggle for political influence among domestic organized groups. It explains policy in terms of the interests and capacities of groups or coalitions of groups competing within a particular policy arena. It is associated with the pluralist theory of politics and views policy as the outcome of competitive struggle among affected groups for influence over particular policy decision.[22]

As the interest group approach has been operationalized in policy studies, it starts with the assumption that interest group involvement is fluid

---

[22]See the classic work of Robert Dahl, *Who Governs?* (New Haven: Yale University Press, 1963). See also David Truman, *The Governmental Process: Political Interests and Public Opinion* (New York: Knopf, 1951).

and variable, as various types of groups form alliances that are contingent on the particular issue at stake; as the issue changes, so changes the interest group alliance. In this approach, the policy outcome on any particular issue is a function of the varying ability of groups to organize and give their interests prominence in the policymaking process.

The interest group approach treats government institutions as simply arenas for interest group competition and do not dwell much on the impact they may have on the policy decisions that emerge. It takes as a given that government officials are regularly responsive to societal demands, pressures, and sanctions. Government officials are usually seen as dependent on societal support and constrained by politically best endowed groups. Some variants of the approach go as far as to characterize governmental actors as groups themselves.[23]

Many early classic studies of the U.S. foreign economic policy, particularly trade policy, were of this analytical mold.[24] Though these studies have been much criticized over the years, in different and more sophisticated guises, the interest group approach still commands a considerable following among the students of foreign economic policy.[25]

---

[23]For example, Earl Latham's "The Group Basis of Politics: Notes for a Theory," *American Political Science Review*, Vol. 46, No. 2 (June 1952), pp. 376-97.

[24]See for example, E. E. Schattshneider's classic, *Politics, Pressures and the Tariff* (New York: Prentice-Hall, 1935).

[25]Notable examples include Jonathan J. Pincus, *Pressure Groups and Politics in Antebellum Tariffs* (New York: Columbia University Press, 1977); Timothy McKeown, "Firms and Tariff Regime Change: Explaining the Demand for Protection," *World Politics*, Vol. 36 (January 1984), pp. 215-33; Peter Gourevitch, *Politics in Hard Times* (Ithaca: Cornell University Press, 1986); and Robert Baldwin, *The Political Economy of U.S. Import Policy* (Cambridge: M.I.T. Press, 1986).

For example, one recent study argues that the way domestic and international economies are integrated affects the preferences of domestic business interests, resulting in predictable foreign economic policy. More specifically, it argues that the increased international economic interdependence in the postwar period has prevented the spread of protectionism by transforming the interest of many domestic firms.[26] The study stresses the role of corporate trade preferences as influenced by the changing degrees of international economic integration over time.

Another study argues that the internationalization of capital markets has served to keep much of the U.S. markets open because powerful economic interests, particularly the U.S.-headquartered transnational financial institutions, are heavily invested in this new international political economy.[27] Compared to the earlier group of studies, these studies take into account the world economic system in sophisticated ways, but they continue to point to the determining nature of the preferences of domestic interest groups. What matters the most is still "domestic social actors' policy preferences, not states' policy instruments."[28]

---

[26]See Helen V. Milner's *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton: Princeton University Press, 1988). Although Milner's research posits business political demands, not the policy itself, as the dependent variable, her argument that the increased internationalization of business has made many firms the opponents of protectionism implies that this preference influences foreign economic policy. She reasons that the internationalization of firms reduces their interest in protection by increasing its cost. She tests this reasoning by investigating the international ties of export dependence, multinationality, and global intra-firm trade.

[27]Jeffry A. Frieden argues that American banks have "self-interested concern for continued international economic integration." See his *Banking On The World: The Politics of International Finance* (Oxford and New York: Basil Blackwell, 1989), p. 196.

[28]Milner, *op. cit.*, p. 292.

Government-Centered Approaches

Government-centered approaches emphasize the role of government officials and institutions. Foremost among the these is the neostatist approach. The core of this approach, as summarized by Eric Nordlinger, consists of the following:

> (1) Public officials' forming their own policy preferences, the extent to which they do so being explained by the state's internal variations, and the preferences being distinctive *vis-a-vis* society's; (2) the state acting on its preferences despite their divergences from those of the most "powerful" private actors with its internal characteristics patterning the frequency and strategy by which it does so, in the past and present; (3) the state's recurring activities and institutional contours' impacting upon society and the efforts of private actors to constrain the state; (4) and the state enjoying analytical priority with its autonomy determinants being used to identify the most important among the societal actors and variables that impinge upon it.[29]

In this scheme, the government's agenda of preferences is very much its own, and government officials treat societal interests as inputs to be selected and analyzed according to the priorities of the government.

Indeed, neostatists emphasize policies themselves, arguing that the examination of popular political pressures is not enough to explain policy outcomes.[30] They argue that the state has its own logic and consequences that do not bend completely to current exigencies, pointing out that executive institutions and executive officials have some ideas about what is for the national good in the international political economy, ideas that are not reducible to "politics as usual." They concede that interest group politics may sometimes thwart government goals, but the "state guardians" of foreign

---

[29]See Eric A. Nordlinger's contribution in "The Return to the State: Critiques," *American Political Science Review*, Vol. 82, No. 3 (September 1988), p. 881.

[30]Many consider Ted Lowi's seminal article "American Business, Public Policy, Case-Studies, and Political Theory," *World Politics*, Vol. 16 (1964), pp. 677-715, as the inspiration for this emphasis on policy output.

policy provide continuity and direction to the general thrust of foreign economic policy.

In stressing the role of institutions, neostatists argue that governmental agencies involved in making foreign policy take on a life of their own, or at least do not rapidly change in response to immediate domestic political incentives. These agencies prescribe normative boundaries on the range of political discourse, and they present barriers for political challengers to the status quo embodied by the institutions. Because of their command over technical expertise, direct connection to the international environment, and agenda-setting powers, officials occupying decision-making positions within these government agencies produce a bargaining path that begins and ends at points other than those stemming from societal politics or the structural dynamics of the world system.

Some analysts have found compatibility between the neostatist approach and realism's description of the world system where each nation acts in regard to foreign policy as if it were steered by a single rational actor responding to the demands of international conflicts and incentives. They use various elements of neostatist thinking to give analytic content to the rational, unified national actor posited by realism. For example, one such formulation argues that the state consists of enduring institutions of government (*viz*, the central norms and organizational characteristics of the executive institutions) and the goal-oriented behavior of the officials in the executive branch of government, especially the elite elements of the national security bureaucracy.[31] In keeping with the tenets of realism, this

---

[31]See G. John Ikenberry's *Reasons of State: Oil Politics and the Capacities of American Government* (Ithaca: Cornell University Press, 1988).

formulation emphasizes how executive officials and institutions permit rational responses to the perils and incentives of the international system.

Combining various elements from realism and neostatism, an influential group of studies conducted in the late 1970s attempted to test macropolitical comparisons about the degree to which governments ("state bureaucracies") differed in their ability to direct the nation's response to the challenges of the world economy.[32] One of its working hypotheses was that a "strong state" has much more effective central governmental guidance of responses to the world economy than a "weak state." In practical operationalization, the studies attempted to account for the forms of so-called "industrial policy," or the lack of it, deployed by a country in support of its international economic objectives.

Summary

This chapter briefly described some of the most often encountered analytical approaches in the mainstream literature that may be of use in explaining the dynamics of the U.S. inward foreign direct investment policy. Identifying various tools available was simple; however, finding the right tool, or the right combination of tools, unfortunately, is not as easy. In the following chapter, these tools are critically evaluated for their utility.

---

[32]See Katzenstein, ed., *Between Power and Plenty.*

CHAPTER FOUR

Limits of Existing Approaches

By no means the short survey presented in the previous chapter includes all the perspectives on the international political economy and foreign economic policymaking in advanced industrial nations, but it did cover the major types of analytical approaches encountered in the mainstream literature. In this chapter, these approaches are assessed for their utility in explaining the central features of the politics of inward foreign direct investment in the United States in recent years.

What will become clear in this evaluation is that none of these approaches, either singly or in combination, are powerful enough to satisfactorily account for the recent shift in and the shape of U.S. inward foreign direct investment policy. Existing approaches miss an important dimension of foreign economic policymaking process in advanced industrial democracies such as the United States. This gap in the literature requires a search beyond the approaches commonly encountered in the study of international political economy and foreign economic policy formulation.

Economic Approach Assessed

Economists invariably attribute economic and social benefits to foreign direct investment. They believe that the investment provides to the recipient country missing or deficient factors of production such as capital, technology, and managerial skills. They also believe that it provides the host nation with jobs, access to foreign markets for exports of host's products, and increased host government's revenues. Furthermore, they praise it for facilitating a convergence of national policies on tax rates, antitrust policies, and local equity and procurement policies, thereby improving the chances for international integration and checking international conflicts by representing the interest of all against the parochial interest of separate nations.[1]

Given all these positive contributions of foreign direct investment, economists see any government policy that interferes with the free movement of investment as folly and not viable in the long run. Economists argue that all nations gain from the unfettered international movement of investment capital and that the pursuit of wealth, played by liberal rules, is not a zero-sum game: Everyone can gain in wealth through more efficient division of labor, though, conversely, everyone can lose from economic inefficiency.

However, this emphasis on mutual gains and Pareto optimality, where one actor's gain does not cause a loss for another, is premised on an ideal

---

[1]One economist argues that foreign direct investment undermines nationalist foreign economic policies because the free flow of investments blurs the distinction between foreign and national firms. Cross-border investments multiply the links (both inward and outward ties) between national economies, making assessment of real gains and losses from any protectionist or otherwise one-sided policy much more difficult. See Phedon Nicolaides, "Investment Policies in an Integrated World Economy," *The World Economy*, Vol. 14, No. 2 (June 1991), pp. 121-37.

world devoid of interactor comparisons of utility. Such a world is free from what is central to politics, that is, ethical judgement and conflict regarding the just and *relative* distribution of utility. The distinction between absolute and relative gains is the key in evaluating "things political."[2]

The neoclassical economics' emphasis on absolute gains clashes fundamentally with the nature of politics, namely, the constant struggle for positional advantage as a goal in itself or as a tool in achieving other goals.[3] That is, in politics, what matters is power. And the essential fact of power is that power is relational, that power is relative.[4] Thus, even when two nations may be gaining absolutely in wealth through trade and exchange of investments, in political terms, it is the effect of these gains on the relative power position of the nations that is of critical importance to their bilateral relationship.

While the neoclassical economic approach provides an understanding of the market factors that have contributed to the recent deluge of investments coming into the United States, it is not a very good guide to understanding policy choice. The approach lacks proper appreciation of power in the way it analyzes the world, hence it is unable to account for the

---

[2]See Gilpin, *U.S. Power and the Multinational Corporation*, pp. 20-44.

[3]Robert B. Reich, when he was a lecturer at Harvard, asked several groups-- a class of Harvard graduate students, a conference of executives of large American corporations, a group of Wall Street investment bankers, a gathering of senior State Department bureaucrats, a meeting of several hundred citizens of Belmont, Massachusetts, and a gathering of professional economists-- which of these futures did they prefer? (a) Between now and the year 2000, the American economy grows a respectable 25%, but the Japanese economy grows a whopping 75%, or (b) between now and 2000, the American economy grows only 10%, and the Japanese economy grows an anemic 10.3%. A majority of every group except the last voted for (b). The economists all voted for (a). See Reich's article "Do We Want U.S. to Be Rich Or Japan Poor?" in *The Wall Street Journal*, June 18, 1990.

[4]For a good discussion on power, see Dennis Wrong, *Power, Its Forms, Bases, and Uses* (New York: Harper and Row, 1979), Chapters 1-3.

policy selection actually made (versus its notion of what is the ideal) because policy choice is invariably political.

In fact, it is the ideals and the normative vision of neoclassical economics that lead to the exaggeration of order and predictability in economists' view of the U.S. postwar foreign economic policy. Given their faith in the rationality and benevolence, as well as the inexorability, of market forces, economists reflexively argue that the success of the postwar international economy is in large part attributable to the predictable liberal environment provided by the United States and this success will persists as long as the policymakers continue to "do the right thing."

The reality is, as with those concerning trade and currency, the U.S. policy measures affecting inward foreign direct investment in the postwar period have been less than consistent with the neoclassical vision. To begin with, the U.S. government has had tightly controlled investments from Eastern bloc countries and maintains various limits on investment by all foreigners in certain transportation and communications assets, nuclear and hydroelectric power, and several other kinds of domestic assets. And, in recent years, the federal government has begun to take more active measures in monitoring and intervening in foreign direct investment activities in previously unregulated sectors of the economy, a fact that is more significant for the reason that these actions have been directed against investments proposed by long-time trading partners and military allies.

In order to make sense of the real significance of these "wrong-headed" governmental tempering with the workings of the market, an analytical approach that is fundamentally political must be employed.[5] Political leaders care about more than merely maximizing national income. At minimum, policymakers care about the preservation of their country's political sovereignty and territorial integrity-- in short, national security. They do care about wealth to the extent that it is one of the crucial building blocks of national power which ensures security. However, as the postwar U.S. foreign economic policy behavior amply demonstrates, a nation may forgo maximizing economic welfare in favor of more immediate national security objectives.[6] Economists are unable to deal with the concerns of this study because their standard models exclude non-economic motivations crucial to such political calculations.

Liberal Institutionalist Approach Assessed

Liberal institutionalism offers a sophisticated analysis of the breathtaking growth and development of vast global markets and the international cooperation in trade and money in the postwar period; and its logic can be extended to analyze the U.S. response to the enormous inflow of direct investments in recent years. Partisans of this approach would argue

---

[5]Without this political perspective, the importance of power in commercial relations among nations would be missed entirely as it was in Ricardo's discussion of Anglo-Portuguese trade relations or in the economists' response to Robert Reich's survey cited earlier. Power and wealth have always been intertwined and only in quite exceptional circumstances that the "heroic and unrealistic assumptions" of liberal economics even temporarily approach credibility for anybody except professional economists. See Charles P. Kindleberger's *Power and Money: The Politics of International Economics and the Economics of International Politics* (New York: Basic Books, 1970), p. 19.

[6]Robert A. Pollard, *Economic Security and the Origins of the Cold War: 1945-1950* (New York: Columbia University Press, 1985).

that what is significant about the current U.S. policy is its continuing overall openness to foreign direct investment, not the recent discretionary, interventionist government measures. After all, it would be foolhardy for the United States to pursue for long a self-serving strategy driven by short-term political interests because the continuing pursuit of unilateral advantage would surely jeopardize the postwar system of multilateral cooperation.

Liberal institutionalists argue that, as with trade and money, foreign direct investment is another way in which nation-states are now interlinked in a complex web of interests that has developed with the expansion of the global economy. They believe that there is a strong resemblance in the direct investment led market integration of recent years to the financial integration that took place from the mid 1970s to the mid 1980s. Foreign direct investment, which for a long time in the postwar period was almost the exclusive domain of American investors, is now a widespread phenomenon practiced by many firms, large and small, from all industrialized countries, and its rapid growth and tremendous volume in the last two decades have created very complicated international patterns of intra-industry interdependence.

Liberal institutionalists point out that this interdependence has also created a complicated web of international political alliances among groups engaged in and affected by cross-border investments, making *a priori* determination of national policy toward inward foreign direct investment difficult. They would no doubt add that the spillover effect from the international regimes governing trade and finance also prevents any one-sided nationalistic policy response from emerging or becoming very effective.

Certainly, the complexities of global economic interdependence are some of the most significant features of modern international relations.

However, liberal institutionalists, particularly the Grotian ones, are too dismissive of the basic power relationships in the world system, relationships that change over time, in their enthusiasm for global integration. International organizations and actors, whether multilateral conventions or powerful transnational corporate alliances, do have significant effect on the policy options of national governments; however, as many critics of liberal institutionalism charge, regimes and other transnational or supranational actors play largely an intermediary role in the international political economy. Some liberal institutionalists themselves acknowledge the international organizations' role as an intervening variable, influencing the preferences, pressures, and practices already established at the domestic and international levels.

Liberal institutionalists also tend to overestimate the comprehensiveness and the enduring quality of the arrangements for managing the international economic system established after World War II. As Susan Strange charges, facile generalizations about the so-called Bretton Woods regime abound.[7] In monetary matters, for instance, the original Articles of Agreement were never fully implemented, and there was a long "transition period" in which most of the original proposals were scrapped. And, throughout the postwar period, major changes were made-- implicitly or explicitly-- in the way the rules were applied and in the way the system functioned. These decisions and actions were taken by national governments

---

[7]Susan Strange, "*Cave! hic dragones*: a critique of regime analysis," *International Organization*, Vol. 36, No. 2 (Spring 1982), pp. 337-54.

in reaction to their changing views of national interest or else in response to volatile market forces that they neither could not or would not control.[8]

Arrangements governing international trade have been just as contingent in the postwar period. To begin with something obvious, an entirely different set of principles, norms, rules, and decision-making procedures has governed trade between the market economies and the socialist or centrally planned economies. Even within the capitalists world, various forms of preferential market access have been practiced between European countries and their former colonies and between the United States and its political dependencies and military allies.[9]

In fact, the various tariff reductions that have been negotiated through a series of GATT rounds make up only a part of the complex governing structure of international trade; and even GATT arrangements have been subjected to repeated revisions, reinterpretation, and renegotiation. One recent study estimates that only about 15 percent of all international trade can be said to be truly free.[10] Trade in semiconductors, automobiles, airplanes, and not to mention agricultural goods, petroleum, and armaments are just some of the key international transactions that are mediated by governments.

If the global trade and monetary arrangements have been less than comprehensive, stable, or consistent, the arrangements for international direct investment have been practically nonexistent because governments have disagreed on the rules for more than forty years. GATT has no rules on

---

[8]*Ibid.*

[9]*Ibid.*

[10]See Lawrence Krause, "Managed Trade: The Regime of Today and Tomorrow," *Journal of Asian Economics*, Vol. 13 (Fall 1992), pp. 301-14.

international investment; and while the OECD has agreements that deal with the treatment of foreign investments, they are not agreements about liberalization or backed up by GATT.[11]

More so than trade and monetary policies, inward foreign direct investment policy has been dominated by concerns for national interest. An examination of national policies toward inward direct investment throughout the world would reveal that there has been generally little spillover from the international trade and finance regimes. Throughout the postwar period, most countries of the world, including many members of the OECD, simply restricted inward foreign direct investment. Only when they believed that the investment would provide a particular technological or economic benefit did they encouraged it. Although many countries have now eased their tight controls on inward direct investment, they still have the means to restrict investments that run counter to their national economic interest.[12] If they allow foreign purchases of domestic assets, national governments still have the means to use performance requirements, formal and informal, to shape these investments to the host country's advantage.[13]

Liberal institutionalists have contributed much to the depth of understanding of the international political economy by arguing that the world system has to be seen as one of complex interdependence rather than one of brusque confrontation of force and encircling anarchy. They have

---

[11]The Uruguay Round of negotiations that dealt with investment issues referred only to trade related investment measures (TRIMs).

[12]Even in places where formal restrictions no longer exist, there are informal barriers to investment that national governments are unwilling to do anything about.

[13]For example, the requirement for the use of domestic components, the maintenance of certain local production facilities, and especially the licensing of key technologies to local firms.

produced many interesting studies unearthing a wealth of new and useful knowledge about the postwar international political economy; and they have been quite convincing with the argument that regimes, transnational corporations, and other international institutions and actors are significant phenomena in the world system. Nonetheless, they have not been entirely successful in demonstrating that these institutions and phenomena are of central importance in international relations. Even less persuasive have been the more Grotian studies that purport to show that states and their interests are no longer critical to understanding international relations.

In ignoring the importance of competing national interests and power politics, liberal institutionalists underestimate the vulnerability of international cooperation to changes in the perception of national interests or, for that matter, changes in the global marketplaces. Even more so than the evidence gathered from the history of the postwar international trade and monetary arrangements, the facts about the inward foreign direct investment policies of various nations, including the United States, indicate that enduring international rivalries and competing national interests have more to do with the national responses to the international political economy than the complexities of interdependence and the existence of international organizations.

Neomercantilist Approach Assessed

Not surprisingly, neomercantilists see more costs than benefits in foreign direct investment. Many neomercantilists are wary of unrestricted expansion by transnational corporations into both the domestic and foreign markets. They argue that foreign interests, through direct investments, may acquire the ability to manipulate the domestic economy of the host or to deny the host's access to strategically important materials, or may in some other ways reduce the host government's effectiveness and room for maneuver in the international arena.

Some neomercantilists even doubt the benefits of outward foreign direct investment by domestic transnational firms. They argue that heavy outward investments in areas of little strategic value by domestic concerns may at times lead to pressures for political intervention that would distract attention away from vital interests as well as lead to squandering of resources.[14] They argue that national security demands a concentration of investment at home rather than its dispersal abroad, regardless of whether the rates of return abroad are higher or not.

Hence, neomercantilists would see as significant the recent changes in the U.S. inward foreign direct investment policy more than liberal institutionalists would and point out that these changes cannot be fully understood without referring to the shifting configuration of power in the international system to which the recent change in the U.S. policy posture was a response. And two of the key features of the changing international system are the rise of Japan as an economic superpower and the accompanying link between the dollar and the yen that some describe as the "*Nichibei* economy."[15] Neomercantilists would argue that the

---

[14]See Gilpin, *op. cit.*, pp. 7-8.

[15]Gilpin argues that, with the wane of its economic strength, the United States has come to need a partner, Japan, to help support the dollar. During the tumultuous 1970s, the OPEC friends of the United States aided in propping up the dollar; recently, the Japanese have assumed the burden. See his *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987). On this new linkage between the United States and Japan,

transformation of U.S. inward foreign direct investment policy from that of benign neglect to that of selective restrictions on foreign, particularly Japanese, investments in the high-technology sector is motivated by strategic considerations involving national security.

Unquestionably, the increasing economic integration of the U.S. and Japanese economies has altered the dynamics of the world economy.[16] However, neomercantilists would argue that what has transformed the international political economy is more than the simple fact that Japan has become a wealthy country; rather, it is the fact that Japan has emerged as America's most important economic competitor, vying with the United States not just for markets and but for technological leadership.

Of course, many would point out that the global economy exhibits unmistakable trends that have developed a momentum all their own, and the United States and Japan are now caught up in a mix of economic forces that they cannot fully control. However, neomercantilists would counter that the two nations now find themselves to be the most powerful states in the international political economy, and the increasing globalization of markets, the unprecedented level of international interdependence among countries, and the mixture of economic forces with domestic politics and foreign policy goals are contributing to tension and suspicion between the two nations as much as fostering cooperation.

---

see also Kent E. Calder's "The Emerging Politics of the Trans-Pacific Economy," *World Policy Journal*, February 1985, pp. 593-623.

[16]In trade, production, and finance, the United States and Japan are increasingly interdependent. The two countries make up 40 percent of the world economy, and the massive trade flows between the two economies, the evolving alliances among their transnational corporations and financial institutions, and the key role of Japanese money in the U.S. economy have transformed the relations of these two countries from one of superior and subordinate to a more equal partnership.

As already discussed, there has been the rise of revisionist views on both sides of the Pacific stressing the divergence of U.S. and Japanese interests with the waning, then the end, of the Cold War. In Japan, important political and business leaders have called for a greater assertion of Japanese national interests in dealing with the United States.[17] While in the United States, establishment figures such as the former secretaries of state Henry Kissinger and Cyrus Vance have publicly endorsed "managed trade" with Japan[18] Many in the United States have come to the conclusion that Japan is different from other capitalist countries and that the differences are hurting the United States while Japan is changing too slowly to mitigate the problem.[19]

Clearly, the United States and Japan have entered the 1990s with not only the economic side, but the security side, of their relationship at risk. According to some, now the conceivable scenarios for the U.S.-Japan

---

[17]See Akio Morita and Shintaro Ishihara, *The Japan That Can Say No* (unpublished manuscript, unofficial Department of Defense translation). It is interesting that the Department of Defense found it alarming enough to have it translated into English as soon as the book was published in Japan. An official English edition appeared with Morita's contribution omitted as *The Japan That Can Say No: Why Japan Will Be First Among Equals* (New York: Simon & Schuster, 1989). It has been said that Morita, as the chairman of Sony, did not want to offend American sensibilities.

[18]See Henry A. Kissinger and Cyrus R. Vance, "Bipartisan Objectives for American Foreign Policy," *Foreign Affairs*, Vol. 66 (Summer 1988), pp. 899-921. Others who have also advocated a tougher line with Japan include such business notables as Lee Iacocca, Pete Peterson, Felix Rohatyn, and the late Malcolm Forbes.

[19]For example, according to some, Japan's trade presents a completely different pattern from those of other OECD countries. They argue that Japan's trade strikes at the heart of GATT. Unlike other OECD countries, Japan does not import much in those sectors in which it is a major exporter, creating winners and losers in its exchange with the rest of the world. See Stephen S. Cohen with John Zysman, "Countertrade, Offsets, Barter and Buybacks," *California Management Review*, Vol. 28, No. 2, pp. 41-56. A State Department official even played on the old enemy/new enemy perception by calling for a "Team B" intelligence analysis of U.S. policy toward Japan, referring to the "Team B" assessment of the Soviet strategic threat conducted by conservative analysts outside the official intelligence community during the Ford administration. See Kevin L. Kearns, "After FSX: A New Approach to U.S.-Japan Relations," *Foreign Service Journal*, December 1989, pp. 43-8.

relationship include political rivalry and, ultimately, armed conflict.[20] While a war between the United States and Japan is hard to imagine, the trends in the bilateral relationship are increasingly being shaped by narrower issues such as sectorial competition and technology rivalry rather than broader issues concerning the geostrategic environment and the health of the larger global economy. The recent series of acrimonious trade disputes and the FSX fighter debacle illustrate the potential long-run problem.

Despite their sometimes brusque dismissal of the complexities of global economic interdependence, neomercantilists correctly point to the changed power relationship between the United States and Japan with regard to the trajectory of the U.S. inward foreign direct investment policy. Their stress on power sometimes overplays the security dimension of the international political economy at the expense of other dimensions, and their insistent nationalist tone can be overwhelming at times. Nonetheless, the neomercantilist approach's very emphasis on political rivalry and conflict is its particular strength, especially in giving shape to the history of international political and economic relations. While mainstream economists and some liberal institutionalists assume that world markets arise through the apolitical pursuit of economic interest and the recognition of comparative advantage, neomercantilists rightly argue that the evolution and expansion of the world economy have depended on the existence of centers of international political-military power.

---

[20]At the extreme is the sensational speculation by George Friedman and Meredith LeBard in their *The Coming War with Japan* (New York: St. Martin's Press, 1991). They argue that the diverging national interests of Japan and the United States will bring war between the two countries early in the next century.

Society-centered Approaches Assessed

The interest group approach, a leading example of society-centered approaches, would argue that a powerful coalition of interest groups keeps the United States open to foreign direct investment because it is able to muster political and financial resources to commit the U.S. government to the maintenance of liberal investment environment abroad as well as at home. The reality is that there are now more U.S. businesses engaged in investment activities in other countries than any time before as well as dependent on foreign sources of capital and technology at home. Indeed, a plausible argument could be made that the increasing integration of all types of domestic firms-- not just the largest corporations but a rapidly increasing number of medium-size and small businesses-- to the larger international economy *via* exchange of investments or joint-ventures with foreign partners has created a powerful vested interest that exerts enormous influence on the U.S. government to maintain a liberal environment for investments.

The interest group approach could also incorporate into its logic other important domestic interests other than U.S.-headquartered transnational enterprises. It could be argued that even labor unions, though with some ambivalence, favor openness to inward direct investment because certain kinds of direct investment create domestic jobs. While labor groups have traditionally opposed outward direct investment by U.S. companies, they have looked upon inward direct investment as a better alternative, or a potential solution, to the loss of American jobs to foreign competition or offshore production by American employers.[21]

Furthermore, the interest group approach could point to the investment-hungry local governments and well-funded foreign lobbyists (treating foreign investors as another "domestic" interest group) that add further strength to the coalition of interests that keeps the United States open to foreign direct investment.[22] In fact, despite the populist, xenophobic reaction to the rapid rise of foreign investment in the United States, officials from many states and municipalities continue to seek out foreign investment for their localities. In some ways, these local officials have led the nation in shaping an important aspect of the *de facto* inward foreign direct investment policy.[23]

Nonetheless, the interest group approach cannot readily explain the rise of government measures investigating, discouraging, and blocking foreign investment in certain sectors of the economy as well as the undeniable restrictive trend in policymaking in recent years, despite some

---

[21]Of course, it is arguable whether or not inward foreign direct investment has any net positive impact on domestic employment. However, the argument justifying the enactment of the so-called "voluntary export restraint" (VER) on Japanese automobiles-- which encouraged Japanese "greenfield" investments in the United States-- was grounded on the hope of such a positive employment effect. Unions are now more sober about their expectations. It is not simply UAW's lack of progress in organizing American workers in the new "transplant" factories that is at the center of labor's growing ambivalence toward foreign direct investment. Among other disenchantments with foreign direct investment, many union leaders have come to believe that foreign owners obtain more of their production inputs from abroad than do domestic firms and that the resulting reduced demand for domestic products adversely affects both union workers and the U.S. trade balance.

[22]Some insist that the lobbyists working for foreign, especially Japanese, investors constitute a powerful, "anti-democratic" force in Washington. See, for example, Pat Choate, *Agents of Influence* (New York: Alfred A. Knopf, 1990).

[23]They have provided a good deal of leadership and persuaded the taxpayers to allocate resources for attracting foreign investment into the country. Their expected return for these efforts is the creation of jobs for their constituents, an obvious electoral asset.

regulatory liberalization in other areas of the economy. If the dominant coalition (if such a group exists) in the inward foreign direct investment policy arena is liberal in nature, what explains these regulatory activities?[24] Are these government actions simply inconsequential anomalies that can safely be ignored?

Perhaps the policy activism could be explained away by utilizing a "public choice" variant of the interest group analysis.[25] A theoretically more sophisticated form of analysis than "vector analysis," its central contribution is the replacement of the assumption of purely decentralized interaction among individual groups with analyses involving collective action, collective decisions, and, thus, collective choice processes, rules, and procedures.[26] Based on the logic that groups with more vital and more immediate stakes tend to organize more readily than others and dominate the political process, perhaps an argument could be made that the effective lobbying by interests that may suffer from inward foreign direct investment accounts for the restrictions.[27]

---

[24]As some point out, the "group" in the interest group analysis is a notion too amorphous for an understanding of its formation, cohesion, or external effectiveness. See Mancur L. Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge: Harvard University Press, 1965), pp. 16-22, and Richard L. Posner, "Theories of Economic Regulation," *Bell Journal of Economics and Management Science*, Vol. 5 (Autumn 1974), pp. 335-58.

[25]Interest group studies of the public choice type have documented industries and firms' rent seeking and its effect and have provided insights into how small, organized groups may have more political efficacy at times than do unorganized majorities: An argument could be constructed that gives account of the successful protectionist lobbying efforts by firms and industries competing with foreign counterparts that have affected the foreign direct investment policy as well as the directly targeted "fair trade" policy.

[26]See Samuel Peltzman's influential work, "Toward a More General Theory of Regulation," *Journal of Law and Economics*, Vol. 19, 1976, pp. 211-40.

[27]On the other hand, one could just as well argue that the gainers from inward foreign direct investment will be highly sensitive to government policies and have the incentive to organize but it will be more difficult to identify the losers. Some competing domestic firms in the

There is some *prima facie* evidence to support this line of argument. There have been some conspicuous examples of political lobbying by U.S. firms against foreign takeovers and investments in their industries. However, this kind of political activism has been less than consistent and, generally, has been to be limited to firms in the high-technology sector of the economy. In other sectors, there has been very little activity unless the investment was a hostile takeover attempt. Still, even in those few cases where the domestic firms doggedly resisted foreign takeover attempts by calling on the government to intervene, the high profile appeals to the public authorities for "protection" were quickly withdrawn after more satisfactory terms of merger or acquisition were obtained from the foreign investor.[28]

The problem is that, in interest group studies, the analysis becomes problematic when a group's interests are multiple or uncertain, then the analyst searching for only group interests is not likely to discover an adequate explanation for policy formation. For instance, what is the interest of IBM which sources many components of its line of personal and mainframe computers from foreign-owned firms? Is IBM's interest better served by lobbying for restrictions on certain kinds of foreign investment in this country and government subsidies and protection for its domestic suppliers so that there are American sources of components or by lobbying for openness so that it can obtain its supplies at the best possible prices? How about a firm such as Texas Instruments? Though it is an American firm, it has a major base of manufacturing as well as research and development in Japan. It also

---

targeted industry might feel threatened by the foreign investment, but the affected group will probably be diffuse.

[28]For example, Beazers' takeover of Koppers in 1988 and BTR's takeover attempt of Norton in 1990.

has a number of vital alliances with Japanese firms to share technology and market products worldwide. Is it really possible to predict with certainty how Texas Instruments, with its numerous divisions and global "profit centers" that may have conflicting priorities, is going to react to a Japanese or French takeover of one of its domestic suppliers?[29]

Some interest group analysts have argued that firms facing strong import penetration lobbies against protection if they also depend heavily on exports or global production. However, in reality, corporate interests are far more fluid and complex. Even the most competitive firms seek government intervention if they face barriers to their exports and investments overseas as a way of opening up business opportunities abroad and punishing those protectionist countries.[30] Because of the intensifying global competition, even the most efficient and international of U.S. firms can no longer be specified as, *a priori*, the proponents of free trade and open investment policies. Diverse firms such as Citicorp, Boeing, and AT&T, which have traditionally championed free trade and open investment, are increasingly demanding that the federal government impose sanctions on products, services, and investments from countries with closed markets and engaging in predatory trade and investment tactics.

---

[29]It is interesting to note that, since many U.S. chip makers are now ensconced in the Japanese market with the help of the U.S.-Japan Semiconductor Agreement of 1988 and have joint research or manufacturing agreements with their Japanese counterparts, they are now arguing that quotas are not needed anymore. After all, why open the market up further and encourage others to enter? See Andre Pollack, "After a Long Fight, U.S. Yields on a Vital Chip-Making Tool," *New York Times*, June 6, 1993, and Bob Davis, "Getting Tough: Officials Who've Done Business With Japan Frame Trade Policy," *Wall Street Journal*, June 8, 1993.

[30]Recently, a number of large domestic financial services firms have lobbied Congress for a reciprocity policy in banking and other financial services authorizing the government to deny foreign financial firms the permission to establish or expand their businesses in the United States if their home governments do not grant U.S. entities comparable opportunities.

The reality gets still more complicated. Even General Motors, ailing from strong foreign competition, would object to overzealous government regulation of foreign direct investment in the United States for the fear of retaliation against its overseas subsidiaries which tend to be more profitable than their domestic operations. Nonetheless, General Motors have in the past, and may still, lobbied against the expansion of Japanese car manufacturing capacity in the United States, although it originally lobbied for the voluntary export restraint on Japanese automobiles which encouraged the Japanese investments in the first place.

The interest group approach, particularly the old-style coalition type, can also be criticized on purely theoretical grounds.[31] One of the central weaknesses of this approach is that each group participant is regarded as a datum where the large coalition of groups beats smaller coalitions. In its extremes, the analysis inspired by the approach amounts to nothing more than an inventory of group participants and their strategies in a given political process. The danger of this is that power is attributed to each coalition in terms of inferred patterns of advantage and indulgence in the final decision. The virtue of the interest group approach is that it can be applied to any political situation, but often the findings of the studies directed by the approach are not cumulative because, in the absence of logical relations between theory and propositions, the analysis becomes self-directing and self-supportive.[32]

---

[31]See Lowi's "American Business, Public Policy, Case-Studies, and Political Theory."

[32]Some argue that, while the interest group approach can be made to "travel far," it is questionable whether this kind of conceptual stretching can explain much. They argue that analyses utilizing the approach are not conducive to generating related propositions that can be tested by research and experience. Lowi charges that, in the past, the research based on the interest group approach generated case-study after case-study that "proves" the model with

Government-centered Approaches Assessed

One analyst examining the contemporary U.S. inward foreign direct investment policy suggests that, because the United States has a "weak" state, it is forced to combat reduced international economic competitiveness through invoking the principles of free and fair trade in order to delegitimate the foreign competition and legitimate the imposition of trade barriers to discourage foreign imports and encourage direct investment by foreign firms. He argues that this weakness of the American state ensures that policy change is incremental and the incentive structure that results from it pushes politicians to seek short-term, "outward" solutions with undesirable economic and political costs in terms of both the balance of payments and state autonomy.[33]

However, such an abstract and aggregate conceptualization of the political system as "strong" or "weak" tends to have trouble explaining the variation in capabilities and effectiveness among regimes of a particular type, across issue areas, or *vis-a-vis* different social groups. There may be some analytical advantages to a macro, unified conception of government found in many neostatist writings, particularly when conducting a comparative study of various national policies; however, the benefits are limited when the focus of the study is the dynamics of a particular policy of a given nation over a period of time.[34] The generalization that the state is weak in the United States gives few clues about which of the several alternative policies toward

---

findings directed by the methodology of the approach itself; that is, the studies merely provided the basis for repeating the assumptions of the beginning. *Ibid.*

[33]See S. Reich's "Road to follow: regulating direct foreign investment."

[34]The approach would fare better if "time" is measured in decades or centuries.

inward foreign direct investment may be chosen or why and how the policy might change. Besides, as Peter Gourevitch observes, "the strong state-weak state argument suggests that...the identity of the governing coalition does not matter."[35] Indeed, this is a very apolitical argument.

In addition to the content, the domain of the state is also fuzzy. Neostatists rightly acknowledge that international incentives and constraints influence national politics and policies, but there remains the important question of when and how? Beyond their realist-inspired efforts to show how the distribution of international power could predict the central attributes of nation's foreign economic policy, they have trouble describing how the international system drives the state. Does an analyst begin with an idea about the international structure, deduce a proper national response, and test to see if the state fulfilled it, or does the international system matter only in an *ad hoc* manner? In the eyes of their critics, neostatists' contribution to the study of international political economy amounts to no more than a patchwork of contingent theorizing whose critical claim is that one should expect special concern for international considerations in the executive branch of government, an attempt to convert domestic policy into foreign policy when advantageous, active attempts by executive officials to shape agenda and selectively mobilize constituencies, and some impact of institutional processes on substantive outcomes.[36]

As a tonic to some of the excesses of societal approaches and representing the analytic middle ground between reducing foreign economic

---

[35]Peter Gourevitch, "The second image reversed: the international sources of domestic politics," *International Organization*, Vol. 32, No. 4 (Autumn 1978), p. 903.

[36]See Cowhey's "'States' and 'Politics' in American Foreign Economic Policy," p. 232

policymaking to bureaucratic politics at the one end and simply assuming an unified rational government at the other, the path taken by neostatists has usefully advanced the state of foreign economic policy studies. It has reduced the danger of treating government institutions and officials as simply passive registers for societal or systemic pressures.

However, the "state" in alarmingly many neostatist writings is an analytic invention without clear empirical content.[37] Some neostatist formulations raise a number of troubling questions: Which government agencies are part of the state? Which norms, regulations, and legislations reflect the state, which reflect societal or electoral pressures? When is a policy simply the outcome of transitory bureaucratic politics and when is it a product of the so-called "state"? As some charge, in many neostatist studies, the state is a wooly analytic shell that is difficult to define operationally. In dealing with the problem of specifying the characteristics of the state, neostatists have put forward descriptions that seem neither empirically persuasive nor theoretically coherent.

While these problems and weaknesses need to be kept in mind, there is great value in the neostatist insight that government institutions and the officials staffing them are instrumental in interpreting the nature of international pressures or imperatives.[38] Government officials and the

---

[37]One of the more comprehensive critiques of "neostatism" is Gabriel A. Almond's "The Return to the State," *American Political Science Review*, Vol. 82, No. 3 (September 1988), pp. 853-74.

[38]There is a need for much caution in operationalizing this insight, however. Krasner argues in *Defending the National Interest* that the state is burdened with a set of formal and informal obligations that charge it with furthering the nation's general interests that are defined as constituting the "utility *of* the community," *a la* Vilfredo Pareto, which involves making a judgment about the well-being of the community as a whole. Krasner states the following: "Values are assigned by the state. State objective refer in this study to the utility *of* the community and will be called a nation's general or national interest. The national interest is

bargaining among themselves, as well as with interest groups, exert critical influence over policy choice, while government institutions, as an aggregate, form a piece of strategically important terrain that shapes the course of political struggles and sometimes provides the resources and advantages to win these struggles.[39]

Despite the troubling gaps in the neostatist approach, with regard to the questions concerning the U.S. inward foreign direct investment policy, the approach nonetheless offers some valuable insights, if not in how to analyze, in where to begin the analysis. After all, much of the recent policy measures targeting inward foreign direct investment have had instigators within government, particularly among lawmakers and their staff in Congress and their allies in the executive branch (including the White House) concerned about the economic competitiveness and military security of the country in a time of waning U.S. dominance in high-technology and manufacturing.

As discussed earlier, unlike trade regulations, the policy measures targeting inward foreign direct investment have had no stable or predictable constituency. Although it is clear that the acrimonious politics of trade sometimes spills over into the inward foreign direct investment policy arena, it is difficult to identify the societal beneficiaries of these recent measures. It is puzzling then, rather than the White house, it has been Congress, the branch

---

defined as the goals that are sought by the state." There is an elliptical quality to this statement.

[39]Neostatists would argue that it is important to understand the institutional and legal framework that facilitates or inhibits access to political resources and the decision-making apparatus in the inward foreign direct investment policy arena: Inward foreign direct investment policy and other regulatory policies depend on inherited institutional structures and on leadership choices made by politicians and government officials embedded in those structures.

of government generally ignored by neostatists as the hotbed of interest group politics, leading the policy initiatives in this arena.

Nonetheless, Congress is still part of the American state. And the neostatist approach, while confused about what constitutes the state, is useful for the purpose of this study. While its emphasis on the enduring structures of state and macro-level analysis and penchant for abstract theorizing do not easily lend themselves to application in discrete policy analyses, the neostatist approach nonetheless gives some important hints as to where and what to look for in deciphering the puzzle of the restrictive trend in the U.S. inward foreign direct investment policy and the rise of discretionary government actions against investments originating from a key postwar ally and trading partner, Japan.

Other Approaches Considered

There are other analytical approaches to the study of foreign economic policymaking in advanced industrial democracies. Particularly among government-oriented approaches, there are narrower ones that concentrate on specific government institutions.

Among these, the approach that has had some impact on the study of foreign economic policymaking process in the United States is the interbranch politics approach. Given that the rivalry between Congress and the White House has been a major theme in the study of American politics, the analytical path advocated by the adherents of this approach cannot be overlooked.

Robert Pastor argues that U.S. foreign economic policy is the outcome of the interaction between the executive branch and Congress in which the executive branch tilts the policy objective toward the maintenance of the global economic system while Congress tilts it toward domestic priorities.[40] He suggests that the extent to which respective priorities are assimilated is a matter of the degree of confidence and responsiveness between the two branches and that American foreign economic policy is the product of a continuous, interactive process involving the two branches.

The interbranch politics approach can account for some of the recent developments in the inward foreign direct investment policy arena where the policy has evolved into an uneasy mixture of continuing general openness with discretionary restrictions in certain sectors. Emphasizing the growth of Congress as a more independently capable, unified foreign policy institution and the split-party control of the two branches of government in recent years, it can account for some aspects of the congressional attempt to more stringently regulate inward foreign direct investment as well as the White House opposition to the legislative branch initiative.[41] Indeed, the pressures to regulate incoming investment have generally come from Congress, while the White House has resisted these pressures unless they served its foreign policy objectives, such as opening up markets abroad for U.S. exports and investments or were politically too costly to resist.

---

[40]Robert A. Pastor, *Congress and the Politics of U.S. Foreign Economic Policy* (Berkeley: University of California Press, 1982), p. 61.

[41]The literature on "divided government" is large. For a sampling, see Gary W. Cox and Samuel Kernell, ed., *The Politics of Divided Government* (Boulder: Westview Press, 1991). See also Thomas Mann, ed., *A Question of Balance: The President and the Congress and Foreign Policy* (Washington, D.C.: The Brookings Institution, 1990).

The interbranch politics approach, however, does not explain why Congress has taken the kind of interest in inward foreign direct investment policy that it has. It can demonstrate that Congress does make a difference in foreign economic policy as a "state institution" and can be, at times, the initiator of foreign policy, but highlighting the institutional capabilities of Congress *vis-a-vis* the White House in foreign economic policymaking does not necessarily show why Congress has acted the way it has on specific issues related to inward foreign direct investment policy.

The argument that U.S. foreign economic policy is a result of two institutions with independent capabilities and biases competing or trying to merge their positions does provide some insights about policy dynamics, but it falls short as a sufficient conceptual guide to the policymaking process and outcomes. In this respect, the neostatist approach, with all its flaws, including its blatant neglect of Congress as a consequential state institution, is a more sophisticated analytical framework in that it considers the international power variable as well as the domestic calculus of power on government institutions and officials. Besides, as Terry Moe observes, there is a tendency among the advocates of the interbranch approach to reify the institution of Congress as though it is an unitary decision maker in the manner of the presidency with the effect that the White House and Congress are portrayed as fighting it out, head to head, over matters of institutional power and prerogatives.[42]

There are also other approaches that exclusively focus on the various bureaucracies of the executive branch or other institutions of government, concentrating on the organizational politics of these institutions. For

[42] Moe, "President, Institutions, and Theory," pp. 373-4.

example, an executive agency centered analysis might focus on the many examples of interagency struggle over turf and prerogative that affect policy outcomes. Though there are very few examples of a legislature-oriented analysis of this type in the study of foreign economic policy, such a study might focus on legislators' goals and on committee recruitment patterns to explore the sources and purpose of policy, arguing that a multiplicity of interests exist among various congressional committees and members.

As a group, the underlying theme of these approaches is that policy results not from the external circumstance of the actors charged with decision-making but rather from within the organization of government itself. In other words, it is the struggle among government institutions and officials and the distribution of power among them that determine policy sources and outcomes. Although these approaches may provide rich details of the internal politics within government institutions, what they reveal may be less if those institutional interests and powers are a reflection of the larger international imperatives and domestic politics.[43] The truth is that they often are.

---

[43]There are still other approaches that examine the differing beliefs and cognition of various policymakers in analyzing the specific outcome of the policy process, though their uses in the study of foreign economic policy formulation have been limited These approaches are better suited to explaining change than continuity: They cannot explain stable policy over a long period of time, where attention must necessarily be directed to the process that selects individuals for key decision-making positions. See for example, John S. Odell, "The U.S. and the emergence of flexible exchange rates: an analysis of foreign policy change," *International Organization*, Vol. 33, No. 1 (Winter 1979), pp. 57-81. See also Paul Egon Rohrlich, "Economic culture and foreign policy: the cognitive analysis of economic policy making," *International Organization*, Vol. 41, No. 1 (Winter 1987), pp. 61-92.

Summary

The assessment above shows what countless other "reviews of literature" have shown; that is, depending on what questions are being asked, all analytical approaches have their uses and limits. This is hardly surprising because public policies of advanced industrial democracies tend to be highly overdetermined. There is no one approach that will, by itself, provide a compelling explanation for most political phenomena worth studying, though some approaches will be clearly more useful than others in explaining certain aspect of a subject under study.

The review also revealed that, despite a plethora of theories, there is a lack of analytical instruments in the "tool kit" just inventoried that permit a closer examination of the *politics* of formulation of foreign economic policy. Surely the everyday domestic political processes have some not inconsequential impact on the making of foreign economic policy in an advanced industrial democracy, particularly when global forces are having increasingly powerful effect on the day-to-day lives of people who vote. The next chapter will discuss how this shortcoming in the literature might be addressed.

CHAPTER FIVE

Structural Choice and the Dynamics of U.S. Inward Foreign Direct Investment Policy

The previous two chapters showed that, despite an abundance of theories, there is a lack of analytical instruments in the standard "tool kit" that permit a closer examination of the *politics* of foreign economic policymaking. Do commonplace phenomena of democratic politics such as campaign promises, elections, partisanship in government, etc., have any impact on the formulation of foreign economic policy? Certainly they do-- to a degree that is not readily recognized as significant by much of the literature just reviewed. In fact, by thinking about the everyday politics of coping with the international system, not just what a determined statesman in pursuit of the national interest would attempt or what the most powerful business firms might want or what international rules exist or do not exist on certain international economic matter, a deeper level of understanding can be achieved of the foreign economic policymaking process in advanced industrial nations.

Any acceptable explanation of the dynamics of inward foreign direct investment policymaking in the United States must be able to account for the policy leadership of Congress-- dismissed as the "hotbed of petty societal politics" by some-- in this policy arena and answer why CFIUS was created and empowered as the key institution of the regulatory apparatus overseeing inward foreign direct investment. As it will be made clear in the substantive chapters, it was the elected policymakers in Congress who have took the initiative in this policy arena and have, with grudging and conditional cooperation from the White House, patched together the present regulatory framework. The analytical approaches reviewed in the previous two chapters generally do not treat Congress as a policy*making* institution, irrespective of the controversial issue concerning the "coherence" or "rationality" of congressional policy goals.[1]

At the same time, the explanation must be able to account for the motive(s) behind this congressional activism and, despite its antipathy, White House's complicity. Beyond simply pointing to the obvious international forces at work, it must be able to account for the basic political considerations that explain why various elected policymakers defined and responded to the recent upsurge of foreign direct investments as they did. What is needed is an approach that focuses on the politics of policy choice incorporating the calculations of political leaders constrained by larger international factors but driven by more immediate political imperatives.

This chapter presents what is labeled here as the "structural choice approach" as the key element of the metatheoretical analysis that explains the dynamics of U.S. inward foreign direct investment policy in recent years. By concentrating on the dynamics of policy choice, this approach provides the

---

[1]While the interbranch branch approach may be an exception, the findings of this approach are not easily generalizable to other political systems.

critical tool needed for analyzing the shifting parameters of the U.S. inward foreign direct investment policy.

New Institutionalism

The analytical approach advanced here is inspired by the insights generated by new institutionalism.[2] Of course, theoretical perspectives that pass under the label of "new institutionalism" are quite diverse. However, the particular strain of new institutionalism that is of interest here traces its origins to "positive political economy," a school of thought that focuses on microfoundations and utilizes the rational actor methodology of microeconomics.

The insights generated by this influential, but controversial, school of thought have been used to study both the economic behavior in political processes and political behavior in the marketplace.[3] In analyzing the former,

---

[2]On "new institutionalism," see James March and Johan Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review*, Vol. 78, 1984, pp. 734-49. On a more "formal" variant, see John E. Chubb and Terry M. Moe, "Controversy: Should Market Forces Control Educational Decision Making?" *American Political Science Review* Vol. 84, 1990, pp. 558-67. Occupying the middle ground, arguing that their rational choice approach can be combined with more interpretive analyses, is Mathew D. McCubbins, Roger G. Noll, and Barry R. Weingast, "Positive and Normative Models of Due Process: An Integrative Approach to Administrative Procedures," Stanford, CA: Hoover Institution, Working Paper P-90-10. Also see John Ferejohn, "Rationality and Interpretation: Parliamentary Elections in Early Stuart England," in Kirsten Renwick Monroe, ed., *The Economic Approach to Politics: A Critical Reassessment of the Theory of Rational Action* (New York: HarperCollins, 1991), pp. 279-305.

[3]Positive political economy seeks both to furnish an understanding of optimal choices in various institutional settings and to endogenize those institutional settings. Of course, there is nothing new and distinctive in these two concerns when considered separately as distinct issues. However, the distinguishing characteristic of positive political economy is that it assumes these two questions to be intimately related, and it insists on treating the two concerns simultaneously. See the "Editors' introduction" in James E. Alt and Kenneth A. Shepsle, eds.,

the analysts of this school use an economic approach (constrained maximizing and strategic behavior by self-interested agents) to explain the origins and maintenance of political institution and the formulation and implementation of public policies. In analyzing the latter, they emphasize the political context in which market phenomena take place.[4]

Of the greatest relevance here is the body of works by scholars who focus on how political processes shape policy by uncovering how different institutional forms affect policy outcomes. The research guided by this "structural choice approach" has mostly concentrated on the legislative institutions of government. After all, much of the approach is rooted in social choice theory which centers on voting.[5]

This body of research has explored the various ways that institutions bring stability to the inherently unstable world of majority rule voting. It has also delved into how the legislature's internal organizations and rules might have formed in the first place and how legislators deal with issues of institutional choice.[6] By incorporating insights from the new economics of organization, however, analysts such Kenneth Shepsle, Mathew McCubbins, Roger Noll, Barry Weingast, and others are now exploring the aspects of

---

Perspectives on Positive Political Economy (Cambridge: Cambridge University Press, 1990), pp. 1-5.

[4]In other words, positive political economy is the study of rational decision making in a context of political and economic institutions. It is concerned with how observed differences among institutions affect political and economic outcomes in various social, economic, and political systems, and how institutions themselves are affected by individual and collective beliefs, preferences, and strategies. In effect, these concerns are about equilibrium in institutions and about institutions as equilibria. *Ibid.*

[5] Moe, "President, Institutions, and Theory," pp. 354-5.

[6]Here, the internal structures of Congress-- committees, rules, etc.-- have been the focus of empirical research.

legislative behavior that involve nonvoting institutions and non-electoral types of relationships such as the oversight of bureaucratic agencies.[7]

Indeed, of particular interest here is the line of research that focuses on the electoral incentives that demarcate the limit elected policymakers have for activist, systemic control ("police patrol") over bureaucratic agencies to which they delegate power.[8] One of the main contentions of this research is that activist supervision of bureaucratic agencies by elected officials has limited electoral attraction either because agencies generally comply with the intent of politicians or because they do not damage politicians' interests while activist type of supervision has opportunity costs because elected officials could be expanding their limited resources on other objectives. Hence, the implication is that politicians will fashion the decision-making process in agencies that they delegate power to in ways that will promote compliance with policymakers intent. If not, they will make it easier for affected constituents to obtain access to governmental institutions.

The research also suggests that elected officials who want to influence policy have reasons to prefer procedural innovations over police patrol oversight. Because procedural changes are often seen as neutral, politicians find it easier to build a winning coalition around a procedural change than

---

[7]See Kenneth A. Shepsle, "Institutional Equilibrium and Equilibrium Institutions" in Herbert F. Weisberg, ed., *Political Science: The Science of Politics* (New York: Agathon, 1986). Also, Mathew D. McCubbins, Roger G. Noll, and Barry R. Weingast, "Administrative Procedures as Instruments of Political Control," *Journal of Law, Economics, and Organization*, Vol. 3, No. 2 (1987), pp. 243-77. For an excellent description and uses of the new economics of organization, see Terry M. Moe, "The New Economics of Organization," *American Journal of Political Science*, Vol. 28, No. 4 (November 1984), pp. 739-77.

[8]See McCubbins, Noll, and Weingast, *op.cit.* and their "Structure and Process, Politics and Policy: Administrative Arrangements and Political Control of Agencies," *Virginia Law Review*, Vol. 75 (March 1989), pp. 431-82. See also Mathew McCubbins and Thomas Schwartz, "Congressional Oversight Overlooked: police Patrol Versus Fire Alarms," *American Journal of Political Science*, Vol. 28 (February 1984), pp. 165-79.

around a substantive policy change. They know that they can preempt and counter a policy before it gains momentum. They also have incentive to shift the burden for monitoring the behavior of agencies to other groups because it frees them to work on other issues.[9]

As already mentioned, however, much of the empirical work employing the structural choice approach has centered on the U.S. Congress. There has been relatively little work done so far to expand the application of the approach's insights to other branches of government. Also lagging behind has been the effort to study public policymaking processes across national boarders employing the approach. Fortunately, there are some promising efforts on the way to analyze the executive institutions of government as well as the beginnings of comparative studies.

Extending the logic of the structural choice approach to the study of the U.S. presidency, Terry Moe argues that the organizational imperatives of the presidential institution can be understood in much the same way as those of Congress, though the distinction has to be made that the presidency is a unified institution in that it serves the interest of the president, not a group of many coequals.[10] This means that, in comparison to legislators, presidents are spared in policy decision-making the many problems of collective action and do not need to establish complex organizations for mitigating them.

Moe argues that presidents have great incentives to create structures that provide a capacity for effective leadership. Where as legislators do not have much incentive to create effective organizations, presidents are keenly

---

[9]Although many new institutionalist studies assume politicians are single-minded seekers of reelection, the assumption is not critical. See McCubbins and Schwartz, *op. cit.*, p. 167.

[10] Terry M. Moe, "President, Institutions, and Theory," p. 367.

concerned with governance. This means that presidents are the only players in the politics of structural choice who are motivated to seek a unified, coordinated, centrally directed bureaucratic system. They want a bureaucracy that can be controlled from the top because, if there is a single driving force that motivates all presidents, it is leadership.[11]

In addition to the extension of inquiry into executive institutions, there are now efforts to utilize various insights of new institutionalism in examining, comparatively, public policymaking in advanced industrial countries.[12] For example, Peter Cowhey points out that politicians, not bureaucrats, are the "political principals" in making public policy in democratic political systems. He argues that, in analyzing foreign economic policymaking in advanced industrial democracies, the analytical importance of politicians must be raised to the level of importance that neostatist studies assign to those "state officials" in charge of various foreign policy agencies of the executive bureaucracy.[13] In outlining a strategy for comparative research on foreign economic policy formulation in industrialized democracies, he stresses the pivotal role played by elected policymakers who determine the amount and types of discretion granted to foreign affairs bureaucracies in a manner consistent with their respective institutional and electoral calculations and anticipated problems of overseeing delegated powers.[14]

---

[11] *Ibid.*, p. 364.

[12] See Cowhey's "Domestic institutions and the credibility of international commitments: Japan and the United States," *International Organization*, Vol. 47, No. 2 (Spring 1993), pp. 299-326.

[13] In analyzing the United States, Cowhey treats the members of Congress along with the president as the ultimate holders of power in the political system. See his "'States' and 'Politics' in American Foreign Economic Policy."

[14] *Ibid.*

Elected Policymakers as "Principals"

Given that the existing literature on foreign economic policymaking in advanced industrial nations lacks a proper appreciation of domestic political imperatives in deciphering the calculations underlying policy choice, the structural choice approach provides a tonic to the extent that it focuses on elected policymakers and their policy decisions. Indeed, among other considerations, electoral incentives (not to be confused with interest group politics) set some predictable parameters for choosing among competing bundles of collective goods and key features of the programs to implement as policies.[15]

As Cowhey outlines in his "political choice theory," elected policymakers act as entrepreneurs on behalf of their political goals, and the search for electoral gains by rewarding supporters with policy instruments is the motive of the entrepreneurial political process.[16] Even beyond the fulfillment of substantive goals of public policy, gaining the electoral advantage is the top priority of elected policymakers (though, in the United

---

[15]Interest groups do matter, but they are only one subordinate part of the larger political game of building electoral support: Their influence is variable and contingent on broader electoral incentives and processes. The electoral connection suggests interest groups' influence depends to some extent on how many voters they employ, where they do business, and the degree to which interests convince politicians that they have successfully identified a broader political payoff. Gathering electoral support, however, is not a passive activity. Congress and the executive branch design policy channels to bolster the influence of voting constituencies who might otherwise find it hard to compete for attention. The argument here follows some of the arguments of R. Douglas Arnold. See his *The Logic of Congressional Action..* See also his "The Local Roots of Domestic Policy," in Thomas Mann and Norman Ornstein, eds., *The New Congress* (Washington, D.C.: American Enterprise Institute, 1981).

[16]Cowhey, *op. cit.*, p. 233.

States, the president gives priority to the establishment of political power within government as Moe points out).[17]

This does not mean, however, the structural choice approach reduces everything down to electoral politics in all this. It recognizes the fact that political entrepreneurship takes place in an institutional setting which is historically bound and permeable to international pressures and incentives. This is one of the principal strengths of the approach.

Institutions and Policymaking

Indeed, the structural choice approach has much to say about institutional arrangements created by politicians to resolve collective choice problems in government.[18] These arrangements range from parliamentary rules of procedure to the delegation of power. In fact, delegation of power to an agent is a particularly useful way of resolving collective choice problems, and it is an important phenomenon within Congress as well as within the executive branch and between the two branches.[19]

---

[17]Moe, *op. cit.*, pp. 363-72.

[18]Cowhey refers to these arrangements collectively as the "production function" of policymaking process which deal with the way politicians face the familiar hazards of collective choice, e.g., the difficulty of achieving stable policies because of Arrow's paradox, and the problems related to the inability to enforce and monitor collective agreements. Cowhey, *op. cit.*, p. 242.

[19]In one example of this phenomenon, as it operates within the legislative branch, Cox and McCubbins point to the delegation of power to party leadership in Congress which creates incentives for leadership to look at the "big picture." Thus, delegation means that the congressional leadership, not just the president, has an incentive to look at both the national strategic picture as well as local particularistic politics. Neostatists have largely ignored this dynamic, concentrating on the international system and apparent national interests as the molds for foreign economic policy. See Gary W. Cox and Mathew D. McCubbins, *Legislative Leviathan: Party Government in the House* (Berkeley: University of California Press, 1993).

Of special interest here is the delegation of power to bureaucratic agencies ("agents") by elected policymakers ("principals") as a way to deal with collective action problems as well as a way to lower direct political accountability for a difficult decision.[20] It allows many problems to be resolved after passing less formidable hurdles than passing a costly and uncertain new legislation. Moreover, the designated agencies can fulfill the broad wishes of Congress and the White House while providing "deniability" to the elected policymakers on unpopular issues as far as there is no law or presidential mandate that needs reversal.[21]

Of course, this delegation of power limits who can make decisions on behalf of the policymakers and, at the same time, sets implicit boundaries on the scope of subsequent actions. It gives the bureaucracy "first mover" advantages; therefore, changing ideology, internal politics and other developments in the bureaucracy may influence policy.[22] In addition, policymakers confront problems of hidden information and action by their agents as well as oligopolistic collusion among agents. This is particularly so

[20]For the microeconomic foundation of the principal-agent model, see Stephen A. Ross, "The economic theory of agency: The principal's problem," *American Economic Review*, Volume 63 (May 1973), pp. 134-9; also, Michael Spence and Richard Zeckhauser, "Insurance, information, and individual action," *American Economic Review*, Volume 61 (May 1971), pp. 380-7. For its application in the study of public bureaucracy, see Barry R. Weingast and Mark Moran, "Bureaucratic discretion or congressional control: Regulatory policymaking by the Federal Trade Commission," *Journal of Political Economy*, Vol. 91 (October 1983), pp. 765-800; also, from a different perspective, see William A. Niskanen, "Bureaucrats and politicians," *Journal of Law and Economics*, Vol. 18 (December 1975), pp. 617-43.

[21]Cowhey, *op. cit.*, p. 246

[22]This is where many neostatists focus their attention, especially when looking at foreign affairs and national security bureaucracies. *Ibid.*, p. 244.

in the United States because there are multiple policymakers in government sharing and competing for power and authority in many policy arenas.[23]

Nonetheless, elected policymakers use a combination of careful scrutiny during the appointment process, monitoring, checks and balances, management by exception, and incentives to overcome the problems of delegation. Politicians do not relinquish ultimate control over these administrative agencies. If the agents fail to suit their needs over time, the delegation of power will be modified.[24] By the same token, elected policymakers anticipate and discount the discretion and "cheating" by agents. Hence, the observation of bureaucratic politics often will not yield very important insights about policy outcomes.

The structural choice approach also permits a more systematic way of dealing with the claim that institutions are not very malleable.[25] In general, when political leaders create institutions, they make the barriers to major new policy initiatives steep because the political costs of such innovation may be great and highly uncertain. Indeed, institutions make it harder to reverse the fundamental priorities of prior political bargains embedded in the institution.

However, once contemplating major shift in policy, elected policymakers often delegate power to new or reconstituted agencies to embody the political bargains that permit the change. Congress often create

---

[23]Agencies such as the Office of the U.S. Trade Representative (USTR), as well as CFIUS, represent a specialized check and balance on the policy process created by competing policymakers to serve their particular purposes.

[24]As Cowhey suggests, the reshuffling of agency jurisdictions over trade policy shows what can be done by elected political leaders. Cowhey, *loc. cit.* See also I. M. Destler, *American Trade Politics*, 2nd ed., (Washington, D.C.: Institute for International Economics, 1992).

[25]Cowhey, *op. cit.*, p. 243.

new or redesign existing agencies and foist them on the executive branch in order to assure some politically important group that its grievances would receive more governmental attention and remain subject to detailed congressional oversight.[26] Change is possible even without a crisis if elected leaders really desire it.[27]

In short, the structural choice approach provides a consistent theoretical basis for predicting when and for what end institutions are created. The very strength of this approach comes from its concern with the question of which agency has been delegated power to discover the political roots of policy.[28] Other approaches usually note only delegated power.

A Metatheoretical Analysis

Although the structural choice approach described above is the key tool needed to answer the questions posed in this study, it is clear that the approach is not the only tool that is needed to explain why the U.S. policy toward inward foreign direct investment has taken the turn and the shape that it has. The fact is that the dynamics of the policy is highly complex. Hence, there are more than one "likely stories" about the making of U.S.

---

[26]As Cowhey points out, institutions are, in effect, a form of political promise to those who must defer some benefits today for other benefits in the future. *Ibid.*

[27]However, it must be kept in mind that institutions act as constraints not just instrumental choices of rational agents desiring certain stable outcomes. For more on this point see, Robert Grafstein's chapter "Rational Choice: Theory and Institutions," in Monroe, ed., *The Economic Approach to Politics*, pp. 259-78.

[28]Cowhey, *op. cit.*, p. 246.

inward foreign direct investment policy, though some will be more plausible than others.

Trend toward Integrated Analysis

As many analysts argue, national-level factors need to be linked with system-level ones if the specifics of a nation's foreign economic policymaking are to be deciphered. After all, strategies of foreign economic policy grow out of the interaction of domestic and international incentives and pressures. A narrow focus on either the internalization of international effects or on the externalization of domestic conditions could lead to gross errors in analysis and prediction.

Over the years, controversies have raged over the primacy of one level or another. Partisans of various approaches have often put forward their particular level of analysis as the most meaningful and productive level; and in careless debates the merits and uses of various levels of analysis have been juxtaposed in ways that are directly competing and exclusionary, resulting in inevitable confusion over the usefulness of various approaches. These debates represent energy squandered.

Particularly unsatisfactory has been the external/systemic versus internal/domestic debate about whether the international or the domestic factors influence foreign policymaking and their outcomes.[29] In analyzing foreign economic policy, it is not often a matter of choosing between the two types of analysis. Depending on what is being explained, it is a matter of

---

[29]Or in Waltzian terms, "inside-out" versus "outside-in." See Waltz, *Theory of World Politics*, p. 63.

discovering the relative importance to be attached to factors at either the systemic or national level and the manner in which these factors can be presumed to relate and interact.

Indeed, answering the questions posed about the dynamics of the U.S. inward foreign direct investment policy requires an integrated analysis of both international and national factors.[30] Happily, as John Odell observes, the trend in scholarship is that many analysts are now resisting the temptation to defend a bold but relatively narrow explanation as sufficient and explicitly combining insights from multiple levels of analysis in the same study.[31]

While there is a great need to reduce complexity and theoretical proliferation, it should not be accomplished at the expense of excluding significant dimensions and findings.[32] The object should not be to select or present one "right" kind of explanation over other "wrong" alternatives, but to use all necessary and relevant analytical implements in the discipline's tool kit to better understand the making of foreign economic policy.

Of course, excessive theoretical pluralism and multi-level analysis present the hazard that the power of the explanation offered in a more encompassing analysis may be uselessly diffuse. Indeed, there is the danger of

---

[30]However, as Robert Putnam suggests, any testable two-level analysis must be rooted in a theory of domestic politics, that is, about the power and preferences of the major domestic actors. See his "Diplomacy and domestic politics: the logic of two-level games," p. 442.

[31]See John S. Odell, "Understanding International Trade Policies: An Emerging Synthesis," *World Politics*, Vol. 43 (October 1990), pp. 139-67.

[32]This is not to minimize the opposite danger of attempting to describe the whole thing. Clearly, there would be no end to the search for relevant variables. The resources would be better deployed in approaches that attempt to capture just the essence of the problem that is interesting or important.

falling victim to "soggy ecumenicalism."[33] However, such a risk could be minimized by carefully relating one type or level of explanation to another and sorting out what the comparative advantages of each approach as applied to different kind of questions. After all, there may be many possible explanations, but they are not necessarily coequals or alternatives, though they may be complimentary. Furthermore, this kind of metatheory approach need not be eclectic: Rather than haphazardly picking and choosing elements of various approaches, as John Ikenberry argues, the object should be to incorporate the most relevant variables into a larger-scale framework.[34]

Explaining U.S. Inward Foreign Direct Investment Policy

All of the common approaches discussed in the survey of literature have something to offer to the analysis of the dynamics of U.S. inward foreign direct investment policy in recent years. However, no one approach by itself, including the structural choice approach, has the sufficient explanatory strength to give a compelling account of why the policy process and outputs have been what they have been-- though there is no doubt that the most relevant of these can shed much light on the puzzle of U.S. inward foreign direct investment policy. Therefore, in order to address the questions posed in this study, a multi-level, metatheoretical approach is required.

Indeed, the analysis offered here approaches the questions from several angles. The first angle involves the examination of the international political

---

[33]The phrase is from George Downs' "The Rational Deterrence Debate," *World Politics*, Vol. 41 (January 1989), pp. 225-38.

[34]G. John Ikenberry, ed., *American Foreign Policy: Theoretical Essays* (Glenview, Illinois: Scott, Foresman and Company, 1989), pp. 10-1.

economy that situates the shifting U.S. policy in the larger context of the changing international environment; the second involves a special focus on the national policymaking process that highlights the role of government officials and institutions; and the third involves the exploration of the dynamics of the policymaking process itself that motivates and limits politicians in making policy choices.

The first two angles are guided by a number of commonly employed approaches reviewed earlier: The first is largely directed by the systemic approaches-- namely the neomercantilist and realism-inspired liberal institutionalist ones-- while the second is, in a more limited way, inspired by some of the insights of the neostatist approach. The third, however, is directed by the structural choice approach. This composite analytical strategy, when employed heuristically, is highly useful in accounting for the policy outputs and the developmental history of the U.S. inward foreign direct investment regulatory apparatus.[35]

When the various analytical components are put together, the metatheoretical analysis reveals that the dynamics of U.S. inward foreign direct investment policy has been driven by elected policymakers' recognition of American vulnerabilities in international economic competition,

---

[35] Of course, the rational actor theory at the core of this composite approach is highly controversial. However, as Terry Moe suggests, rational actor and choice models may be accepted heuristically as "pretheories" that provide a systematic basis for scientific progress. That is, the models may be used as intermediate mechanisms that facilitate conceptualization and analysis through their parsimony and rigor of deductive power, point to relevant relationships, and eventually contribute to the development of empirical laws. Indeed, the definition of "rationality" in these models tend to be restrictive. The central concept of "self-interest" in these models cannot explain such motivation as altruism, not to mention its emphasis on the individual makes the analysis and incorporation of collective ideas such as socialization, norms, and culture quite difficult. See Terry Moe, "On the Scientific Status of Rational Choice Theory," *American Journal of Political Science*, Vol. 23, No. 1 (February 1979), p. 237.

particularly against Japan, and their perception of the political importance of this competitiveness issue in domestic electoral politics. The analysis here integrates the international and domestic levels calculations of elected leaders who are decision-makers at both levels and simplifies the question of "agency" in the link between the two levels.[36] It incorporates international considerations as part of the strategic calculus of elected policymakers who are usually more attuned to domestic politics and markets yet capable of autonomous action in ways described by neostatists. Indeed, while acknowledging the importance of international incentives and constraints faced by a nation, the analysis assumes that-- as Cowhey suggests-- a deeper and more detailed knowledge of the foreign economic policymaking process is obtainable by thinking about the everyday politics of coping with the international system than to guess what is the prevailing balance of power in the global system or what a determined statesman in pursuit of the balance of power would attempt.[37]

The Evidence

The empirical chapters of the study will detail how the growing public antipathy toward Japan stemming from intensifying bilateral commercial conflicts and the realization by politicians that the issue of "economic security" may be utilized for electoral purposes have been contributing to the buildup of regulatory machinery overseeing inward foreign direct

---

[36]The fact that the rational actor assumption is central to many systemic approaches as well as the structural choice approach mitigates the often awkward task of bringing together different levels of analysis.

[37]Cowhey, *op. cit.*, p. 248.

investment in the United States. Indeed, the politics of U.S. inward foreign direct investment policy in recent years has been shaped by the strengthening conviction among many elected policymakers that some kinds of direct investment by foreigners may have the potential to compromise the long-term competitiveness of the country and their perception that this concern is important to the increasingly anxious electorate worried about employment and other economic welfare issues.

The chapters will also examine in detail how this policy apparatus, often the target of political struggle between the occupants of the White House and Congress, was given the potential power to screen almost all inward direct investment in those sectors of the economy considered vital to a new notion of national security: economic security. Its form and function, in fact, reveal much more about the fundamental politics that has been propelling the content and direction of the U.S. inward foreign direct investment policy than its rationality or promise of effectiveness.

The dynamics of this politics is readily recognizable in the institutional evolution of CFIUS, an interagency committee that constitutes the core of the regulatory apparatus targeting inward foreign direct investment. As this study will show, policy entrepreneurs in Congress cajoled CFIUS from the White House as a policy compromise between themselves and the president during the 1970s when OPEC investments alarmed many Americans, albeit briefly. However, as the competitive pressures from abroad increased over time and the electorate growing increasingly wary of Japanese competition (fair and unfair), a new groups of policymakers in Congress has revisited with the White House the terms of the earlier compromise when Japanese investments flooded the country during the late 1980s.

During the late 1980s and early 1990s, policymakers in Congress attempted repeatedly to strengthen the CFIUS mechanism to assure those adversely affected by competition from Japan that competitiveness concerns would receive more political attention from the executive branch and remain subject to congressional oversight while the White House acquiesced to some congressional initiatives in order to minimize the damage to presidential leadership in foreign economic policy matters. It was this kind of interaction between the elected policymakers in Congress and the White House that brought CFIUS into existence in the first place and it continued to redefine the scope and extent of CFIUS's authority and power in regulating foreign direct investment in the United States. This ongoing transformation-- though spasmodic-- in the makeup, mission, and authority of CFIUS produced corresponding shifts in the inward foreign direct investment policy of the United States.

Indeed, the institutional history and workings of CFIUS show that it arose out of the politics of structural choice and have the imprint of the interests, strategies, and compromises of those who wield ultimate political power. They demonstrate clearly that it has been the elected policymakers who have determined the amount and types of discretion granted to CFIUS in a manner consistent with their electoral calculations and anticipated problems of overseeing delegated powers.

CHAPTER SIX

Historical Legacy

In its 1973 report on the status of inward foreign investment in the United States, the White House Council on International Economic Policy (CIEP) claimed that "the United States has always had a policy of welcoming foreign investment."[1] In reality, however, foreign investment-- particularly incoming direct investment-- has been the subject of public controversy and debate among policymakers throughout American history.

Indeed, the U.S. policy toward inward investment has a history far longer than the recent surge of interest in the subject may suggest. While the scope and depth of international investment activities of earlier periods cannot possibly be compared to the enormous size and velocity of present day cross-broader transactions, some of the same attractions and apprehensions (*viz.*, concerns about prosperity and autonomy) toward these investments were operative in the body politics of the nation from its earliest years as an independent, sovereign country.

---

[1] *International Economic Report of the President*, (Washington, D.C.: U.S. Government Printing Office, 1973), p. 62.

This chapter examines the history of the politics of foreign investment in the United States in order to place the contemporary dynamics of the U.S. inward foreign direct investment policy in a broader perspective. To be sure, there are many fundamental differences between the factors determining the policy perspective of the 1980s and that of, let says, the 1870s. Nonetheless, some sort of a historical examination is needed as a tonic for two reasons--first, to correct for the widespread perception that the recent policy movement toward tighter regulation of foreign direct investment in some sectors of the U.S. economy is a historical anomaly and, second, to demonstrate the enduring political importance of national security considerations in the formulation of U.S. foreign economic policy.

It may be that inward foreign investment was not a policy concern only during the first decade and a half following World War II when the containment of international communism was the overwhelming foreign policy objective of the United States and no significant amount of foreign investment was coming into the country. Otherwise, throughout American history, the inflow of foreign investments, particularly of the "direct" variety, has invariably generated apprehension and ambivalence among Americans.

While the degree of policy attention to foreign investment in the United States has fluctuated over time with the intensity of populist sentiment against foreign influence, in general, political leaders in the United States have tolerated and often encouraged inward investment to the extent that they perceived net benefit to their constituents and their own political goals. However, to the extent they perceived such investment endangering national autonomy and/or their opposition to it working in favor of their own political interests in light of public opinion, they attempted to regulate it. It appears that only when Americans felt secure about the relative power of the United States was the question of inward investment of little concern to the political leadership.

America as a Developing Country

Period before the 1800s

The history of U.S. foreign direct investment policy has deep roots. After all, foreign investment in the United States goes back to the earliest days of colonial settlement.

Indeed, one of the defining realities of early American history was that of dependence on foreign capital, particularly British investments.[2] Nearly all the capital required for early American colonization was supplied by the British. In fact, the largest industries before 1800 relied almost entirely on investments from Britain.[3] So great was the dependence that, at the outbreak of the revolt against British rule in 1775, the colonies that were to form the United States were estimated to have compiled around 40 million dollars in debt to the British.[4] This was a sizable figure considering that, before the nineteenth century, almost all manufacturing in the United States were of the cottage industry type.[5]

---

[2]See John H. Dunning, "British Investment in U.S. Industry," *Moorgate and Wall Street* (Autumn 1961), pp. 5-23.

[3]These industries included the following: iron, shipbuilding, tobacco, and naval stores.

[4]Dunning, *op. cit.*, p. 9.

[5]Nonetheless, it must be kept in mind that some enterprises-- such as iron and shipbuilding-- were highly capitalized and quite complex for the time.

Of course, the scale of foreign investment-- particularly direct investment-- was circumscribed by economic and technological limitations of the period.[6] Among the factors limiting direct investment activities were the following: the problem of raising risk capital, the shortage of skilled labor in North America, the scarcity of power supplies, and the absence of reliable and efficient transportation.[7]

Furthermore, the governments of investment "exporting" countries tightly guarded one of the key components of foreign direct investment: technology. All major European nations had strict government restrictions prohibiting the outflow of indigenous technology and know-how.[8] As the leading technological and industrial power, Great Britain had particularly sever restrictions on technology transfer. Nonetheless, considerable knowledge and skills were transferred verbally by immigrants across national boundaries.[9] To be sure, there were no large-scale, technically sophisticated

---

[6]In practice, the distinction between direct and portfolio investment was not always clear cut. Even "paper" investors intervened in the management of firms when things did not go well. Also, many of the earliest inward foreign direct investments were of different kind from those of today because they were of "free-standing" enterprise type. That is, they were assets owned by foreigners but not by foreign firms. An example of such an investment was Du Pont, today one of the largest U.S.-based transnational corporations. Du Pont was established in 1801 by a group of foreigners using French management, finance, equipment, and labor. See William S. Dutton, *Du Pont* (New York: Charles Scribner's Sons, 1942), pp. 26-31.

[7]See Constance McClaughlin Green, "Light Manufactures and the Beginnings of Precision Manufacture," in Harold F. Williamson, ed., *The Growth of the American Economy*, 2nd. ed. (Englewood Cliffs: Prentice-Hall, 1951).

[8]See David J. Jeremy, "British Textile Technology Transmission to the United States: The Philadelphia Region Experience, 1770-1820," *Business History Review*, Vol. 47, No. 1 (Spring 1973), pp. 24-52.

[9]After all, it was difficult to restrict movement of skilled workers given the level of technology for social control at the time.

direct investments made in this period.[10] However, despite this and other limitations on international investment activities, the fact is that direct investments did take place, and the same kind of ambivalence and apprehension that many Americans experienced in recent years toward foreign investment was felt then, at the very birth of the republic.

In fact, the antipathy felt by many colonists toward "foreign" ownership of American assets was one factor that fueled the larger economic grievance against Britain: There was deep-seated resentment among many colonists toward absentee ownership of productive properties in the colonies. Not surprisingly, during the Revolution, various American authorities-- pressured by populist sentiment-- tried to confiscate British-owned assets in North America in an apparent attempt to rid the new country of the shackles of "overseas control." The irony of is that, at the same time, there were others in the new republic who tried to entice investments from France, Spain, and Holland in order to replace the loss of capital flows from Britain.

The success of the Revolution did nothing to end the contradictions in American attitude toward foreign investments. Indeed, with the coming of peace in 1783, many in the United States immediately turned to Britain for investments. American traders and financiers had no qualms about soliciting funds from Britain for business ventures in the United States.

Yet, not all Americans were sanguine about the return of British investments in their new republic. In fact, agrarian interests were particularly suspicious of the British influence in major domestic banks: They feared that the prominence of British and other foreign investment in the domestic

[10]Indeed, at the time, corporate forms were not sufficiently developed to cope with the international transfer of complex technologies. See Jeremy, *op. cit.* An exception might be the case of Du Pont. See Dutton, *loc. cit.*

banking system would drain the country of specie through the exportation of dividends in gold.[11] Indeed, the feelings toward possible British infringement of American autonomy were such that, after the Constitution was ratified, one of the very first acts of Congress in 1789 was to pass a law distinguishing between "domestic" and "foreign" shipping in order to treat American-owned and British-owned vessels differently.[12]

Before the Civil War

Despite America's ambivalence toward foreign capital, investments from abroad continued to come into the country. As the United States expanded westward and its native industries began to grow in scale, foreign investment activities in the country also expanded: Foreigners helped to underwrite its territorial expansion and economic development by contributing to the financing of the Louisiana Purchase, railroads, slaughter houses, and other capital intensive ventures.

During the first half of the nineteenth century, most of these investments were "indirect." Nonetheless, they still represented alien claims on domestic assets. Furthermore, despite the fact that much of the investments were portfolio in nature, foreigners investing in U.S. business concerns exerted not inconsequential influence on how these firms or operations were being managed, given the nature of corporate governance of the time.

---

[11] Bray Hammond, *Banks and Politics in America: From the Revolution to the Civil War* (Princeton: Princeton University Press, 1957), p. 53.

[12] See Geoffrey Gilbert, "Maritime Enterprise in the New Republic: Investment in Baltimore Shipping, 1789-1793," *Business History Review*, Vol. 58, No. 1 (Spring 1984), pp. 15-6.

The British remained the most avid investors the United States. They invested heavily in mines, farm lands, and other productive properties. This led to continuing public suspicions about British infringement of U.S. sovereignty. While the United States had gained political independence from Britain, the steady stream of capital coming from London had much greater impact on the United States in the first half of the nineteenth century than it had previously. No other nation, except Holland, was providing the level of capital to the extent that Britain was.[13]

Although the Napoleonic Wars in Europe and the War of 1812 in North America disrupted trans-Atlantic commerce and had cut offed British investments in the United States, by the 1820s, the British had reestablished their prominent position in the United States. By 1828, about 25 percent of the U.S. national debt was held by British interests; and within the following decade, the majority of the large cotton-producing estates of the American South had been mortgaged to London investors.[14] While a good deal of British funds were invested in U.S. government bonds and various private obligations, as time went by and commercial opportunities widened in the United States, increasingly large amounts of capital found their way into the development of the vast continental transportation network.

There were respected public figures, such as Albert Gallatin and Daniel Webster, who spoke in favor of British and other foreign investments in the

---

[13]In fact, the British and Dutch investments in the United States amounted to almost 10 percent of the U.S. national wealth, a significant sum given the state of international finance during this period in history. See David S. McClain, "Foreign Investment in U.S. Manufacturing and the Theory of Direct Investment," (unpublished doctoral thesis, Massachusetts Institute of Technology, September 1974), pp. 46-50.

[14]Dunning, *op. cit.*, p. 8.

United States.[15] They felt that the United States needed investment capital to grow. They realized that there were risks in foreign control of domestic assets, but they saw that the benefits to the country as a whole were worth such risks.

Nonetheless, there were continuing initiatives throughout this period from both inside and outside of government to tighten government regulation of foreign ownership of domestic assets. In some instances, these pressures prevailed. For example, following the War of 1812, congressional leaders enacted into law in 1817 a "navigation monopoly" for U.S. shipping in the coastwise trade so that this branch of the domestic transportation network would not fall into foreign hands.[16] The resulting controls persist to this day, and only the ships built and owned in the United States can engage in coastal trade.[17]

The level of investments coming into the United States during this period was higher than the pre-independence period but still tiny in comparison with those of modern times. Nonetheless, these early concerns and policy responses show the deep roots of the fear many Americans have about unregulated inward foreign investments. And the question of regulating foreign investment arose with greater frequency as the level of

---

[15]Men such as Gallatin (1761-1849) and Webster (1782-1852) became the successors to Alexander Hamilton in their favorable view toward foreign investment.

[16]One of the considerations motivating those in Congress was the fact that the United States failed to create an adequate ship-building industry or an adequate merchant marine engaged in international shipping. See John G. Hutchins, *American Maritime Industries and Public Policy, 1789-1914* (Cambridge: Harvard University Press, 1941), p. 540.

[17]*Ibid.* In another example, responding to populist pressures, Congress passed a law in 1841 which sought to exclude non-U.S. citizens from purchasing federal land. The Preemption Act of 1841, (5 U.S. Stats. 455).

investment activities dramatically increased in the second-half of the nineteenth century.

America as a Newly Industrializing Nation

The level of investments coming into the United States in the decades following the American Civil War took a quantum leap from that of earlier years. This foreign charge into America in the years following the Civil War was quite dramatic and sudden in part due to the investment risks associated with that painful and disruptive conflict and the lateness of U.S. industrial development compared to that of Europe. Also, a combination of world economic and political conditions drove an unprecedented movement of capital not just to the United States but on a worldwide basis.[18]

One factor was that the world at that time was rather sharply divided into capital-exporting and capital-importing regions whose needs and opportunities nicely matched. Countries such as the United States were just at the takeoff stage of rapid economic development while other mature industrial nations-- principally Britain and, to a lesser extent, the newly united Germany-- were in the position to supply the necessary investment capital from their surplus national savings.

Also, at the firm-level, there were significant factors contributing to the investment activities worldwide. The most important among them was that, in 1862, the British Companies Act was passed in the United Kingdom and,

---

[18] John H. Dunning, "British Investment in the United States 1860/1913," Chapter 4 in *Studies in International Investment* (London: Allen & Unwin, 1970), p. 8.

shortly afterwards, it started to be imitated in the United States.[19] This act was an important milestone and a stimulant to international trade and investment. It allowed the formation of large-scale public corporations and signaled the beginning of the age of limited liability company. The advent of limited liability corporations made possible large-scale industries in the United States, and foreign capital began to pour in directly into American enterprises in significant scale.[20]

The fact that there were no significant political impediments to the migration of investment capital and people also helped. In addition, there were no complicated foreign exchange problems and transfer difficulties because of the rigid fixing of the world's currencies to gold.

The majority of the capital transfer from Europe to the United States continued to originate in London and to be indirect investments in bonds. Although the bonds issued by the U.S. government constituted an important element of American assets in British portfolios at the end of the Civil War, by 1880, the American railway securities were overwhelmingly the dominant component in the British holdings of U.S. assets. Indeed, the principal supplier of American assets to the London capital markets during years 1870 to 1913 was the railroad industry.[21] This British dominance caused much fear and resentment in the United States and sparked a wave of regulations targeting inward foreign investment.

---

[19]McClain, *op. cit.*, p. 84.

[20]Cleona Lewis, *America's Stake in International Investment* (Washington, D.C.: The Brookings Institution, 1938), p. 68.

[21]M. Edelstein, "The Determinants of UK Investment Abroad, 1870-1913: The US Case," *Journal of Economic History*, Vol. 34, No 4 (December 1974), pp. 980-1007.

All throughout this development stage of the U.S. economy, there was much apprehension and resentment of British financial power in the United States. Although there were significant investments coming in from elsewhere, those from Britain were the most visible and the British investors were the most aggressive. By 1913, British holdings in the United States had reached an all-time high of about 3.65 billion dollars and constituted over half of the total inward foreign investment in the United States.[22]

In addition to being still regarded as a potential military threat to the country, Britain was viewed by many Americans in this period as thwarting the long-range national ambition of the United States. There was a widespread belief that Britain's economic, particularly financial, power was hindering the realization of America's place in the world. This belief, and the hostility and frustration it aroused, gave rise to anti-British nationalism which gripped the United States and reached a crescendo in the closing years of the nineteenth century. If Britain were seen simply as a rival in international trade, perhaps American anxiety would not have been so palpable. Rather, this anti-British nationalism sprang from the pervasive uneasiness about the prominent role played by British capital in domestic commercial and financial matters.

This anxiety was most keenly felt by the people of the American West. They depended on British loans and investments as well as British markets

[22]And the British investors were enjoying healthy returns on their American investments. It has been estimated that by the start of World War I, one-tenth of British national income was attributable to earnings on investments abroad, and a good deal of this income had American sources. Dunning, *op. cit.*, p. 10.

for their exports, but they and their political representatives viewed with alarm the heavy and enthusiastic British investment in American cattle ranches, stockyards, mines, land companies, railroads, and other assets. While much of British speculative investments were concentrated in the West, large sums of money were also channeled to opportunities in the Northwest and the South, and in these places populist Anglophobia flourished simultaneously with the desire to seek the benefits of foreign capital.

If the people of the frontier regions where the British corporations prevailed were ambivalent in their expression of hostility toward the British, Anglophobia, if somewhat milder, was more straightforward nationally. Many Americans felt that the British, with their investments, were endangering the nation's destiny as represented by the frontier. In 1880s, there was much enthusiasm in Congress for legislations to deny foreign ownership of various domestic assets. The issue of foreign investment, in the West and elsewhere, played a prominent part in the 1884 presidential campaign as both major parties adopted a restrictive stance on foreign investment in their national party platforms. With continuing public anxiety about foreign infringement on national autonomy and aspirations, federal laws were passed in the late 1880s that curbed alien holdings in the territories.[23]

However, most federal efforts to curb foreign investment activities were largely ineffective; and while federal legislations that were motivated by

---

[23]There were a number of laws passed that attempted to keep domestic assets out of foreign hands. For example, the Alien Property Act (24 U.S. Stats. 476), passed on March 3, 1877, prohibited the acquisition and thereafter the ownership by aliens, or by a company more than 20 percent owned by aliens, of lands in the territories.

silverite pressures made U.S. securities less alluring to foreign investors, the effect was only temporary.[24] Further, there were no attempts made to systematically monitor incoming, or survey existing, foreign investments. The most effective measures targeting foreign investment were in the banking and coastal shipping sectors where the U.S. government imposed specific restraints on foreign investment or on foreign investor's control over their holdings.

The federal government was far more effective in "regulating" foreign investment in that it gave an implicit green light to restrictive local laws. In cases where foreign governments and investors requested the federal government to counteract state and other local laws unfavorable to alien ownership, it was silent or noncommittal. Typical was the response in 1899 by the Secretary of State, John Hay, to one such request that related to onerous local taxes against foreign fire insurers: "Legislation such as that enacted by the State of Iowa is beyond the control of the executive branch of the General Government."[25]

Given the relatively decentralized nature of the American state during this period, the regulation of foreign investment at the local level was indeed more severe and extensive. The local regulations applied to a broad range of assets and activities: land, mortgage lending, banking, insurance, and so on. These regulations were more onerous to foreign investors and were more

---

[24]The concerns about national autonomy was paramount in this reaction against foreign holdings, and it was fueled by the Populist movement and the free silver crusade of the 1890s. The Democratic leaders in Congress, spurred on by the Populists, advocated the free coinage of silver to release the nation from "British thralldom," and the Republicans in response put forth a plan of protectionism with commitment to international bimetallism.

[25]John Hay to Reginald Tower, April 27, 1899. *Foreign Relations of the United States, 1899* (Washington, D.C.: U.S. Department of State, 1899), p. 349.

effective as barriers to entry and hindrance to remaining in business than federal statutes. By 1900, all but fifteen of the forty five states had statutes that distinguished between domestic and foreign ownership of assets.[26]

Foreign Investment in the Manufacturing Sector

Nonetheless, despite these regulatory roadblocks thrown in front of foreign investment, there was no way of halting accelerating international investment activities. This was particularly true of the surge of direct investments in manufacturing begun just before the turn of the century. These investments were spurred on by rapidly advancing technologies and production methods which made manufacturing at such a distance a viable and profitable reality. As time passed, more and more of the investment coming into the United States shifted from loans to equity investments in manufacturing enterprises.

By the first half of 1889, it has been estimated that as much as 200 million dollars in foreign investment had been channeled into the manufacturing sector.[27] Money poured into chemical, automobile, electronics, and other rapidly developing manufacturing industries in the United States. Though the nature of international cartel arrangements of the period limited the free flow of investments in some industries, foreign direct investment coming into the United States grew rapidly; and when this initial wave of investments came to a sudden halt in 1914 with the outbreak of war

---

[26]*London Times*, October 3, 1901, p. 5.

[27]T. C. Coram, "The Role of British Capital in the Development of the United States, 1600-1914," (unpublished M. Sc. thesis, University of Southampton, 1967), p. 329-31.

in Europe, foreign investors had accumulated about 6.2 percent of the manufacturing assets in the United States.[28]

Again, the British were responsible for a significant portion of this new investment pattern; however, the British investors were not the only ones making direct investments in the United States. This period saw the first foray into the expanding U.S. markets by companies that have become some of today's largest transnational corporations, such as Unilever, Nestle, Siemens, Solvay, Bosch, and Royal Dutch Shell.

The Marconi Case

In contrast to foreign investments in the frontier regions, many in the United States welcomed these direct investments in the manufacturing sector; nonetheless, even here, there were some problems. Indeed, there was already a very "modern" pattern of concerns about foreign direct investment: Already in evidence was the policy dilemma associated with foreign claims on technology-oriented assets in the United States. Illustrative of this was the U.S. government policy toward the British-controlled Marconi Wireless Telegraph Company of America.

Marconi America was established in 1899 in the United States only two years following the founding of the parent British company. As the technological innovator, Marconi was the dominant world player in the new wireless communication industry.[29] It assured this market dominance by

---

[28]Peter J. Buckley and Brian R. Roberts, *European Direct Investment in the U.S.A. Before World War I* (New York: St. Martin's 1982), p. 122.

[29]From 1899 until the formation of the Radio Corporation of America in 1919, Marconi companies were the dominant concerns in British and American wireless. Almost all U.S. ship-to-shore radio communication was carried by Marconi between 1912 and 1917. See W. Ruper MacLaurin, *Invention and Innovation in the Radio Industry* (New York: Macmillan Inc., 1949).

having stations all over the world that refused to communicate with ships having equipment other than Marconi. The fact that the British government saw the worldwide network of Marconi companies as the "lifeline of Empire" and did all it could to protect Marconi's interest also helped. Still, the fact that Marconi was the technology leader had the greatest effect. It is telling that the principal early American rival of Marconi, United Wireless, was forced out of business in 1912 and its assets bought out by the British and American Marconi when it was found guilty of infringing Marconi patents.[30]

Although during World War I, the American Marconi erected a state-of-the-art transmitter at New Brunswick, New Jersey, and established a radio equipment manufacturing facility at Aldene, New Jersey, pressure was building in Congress and elsewhere in government to have native control of such a vital strategic industry.[31] The Navy Department was particularly keen on establishing an American-controlled international radio transmission company.[32] The reason was obvious: national security.

The U.S. Navy watched with unease the expanding business of Marconi America. Its worst fear was realized when, in 1901, Marconi insisted on leasing equipments while the Navy wanted to purchase all needed materials outright.[33] The U.S. Navy and its allies in Congress concluded that

---

[30]Hugh G. J. Aitken, *The Continuous Wave: Technology and American Radio, 1900-1932* (Princeton: Princeton University Press, 1985), pp. 192-4.

[31]Buckley and Roberts, *op. cit.*, p. 41.

[32]The Navy took the strongest stand of any government department on questions related to foreign investment. It operated its own radio stations and developed its own expertise in wireless; nonetheless, the British continued to dominate radio communication because of their technological edge.

[33]Gleason L. Archer, *History of Radio* (New York: American Historical Society, 1938), pp. 63 & 78.

the United States, as an emerging maritime power, had to have a reliable and secure line of communication linking its warships of the blue water fleet.[34]

With little urging from the Navy Department, Congress pressed into legislative action to "rectify" the situation. With congressional backing, in 1919, the U.S. Shipping Board refused to allow American Marconi to equip U.S. flagged vessels unless it could provide an affidavit proving that over 50 percent of its equity was in the hands of U.S. citizens. Marconi could not and would not meet this condition. However, with the British dependent on U.S. support in a time of war, the U.S. government forced Marconi's hand with apparently little official British objection. In 1919, the General Electric Company purchased a controlling stake in the U.S. subsidiary of Marconi; and in 1920 the Radio Corporation of America (RCA) was formed by taking over the assets of the American Marconi[35]

However, the Marconi episode was the exception rather than the rule in the U.S. policy approach toward foreign direct investment in the manufacturing sector. Though an argument could be made that perhaps there might have been a stronger attempt at regulation had it not been for the fact that, by this time, the United States was gaining on and surpassing the Europeans in many technological and industrial endeavors.

Even early as 1870, the flow of capital was no longer only in one direction. By that time, several large U.S. enterprises were making direct investments in Europe and elsewhere.[36] Towards the end of the nineteenth

---

[34]See L. S. Howeth, *History of Communications-Electronics in the United States Navy* (Washington, D.C.: Government Printing Office, 1963).

[35]Buckley and Roberts, *loc. cit.*

[36]Dunning, *op. cit.*, p. 149.

century, while the United States was still importing large quantities of European capital, two or three dozen large U.S. firms had set up production units of appreciable size overseas, mainly in Canada and Britain. By the turn of the century, there were between 75 and 100 U.S.-controlled manufacturing plants operating outside the country.[37] The ascendency of the United States as a major economic and maritime power forestalled "defensive" restrictive policies from emerging. Indeed, the rise of the United States as a developed economic power of international stature attenuated the deep-rooted American ambivalence toward inward foreign investment.

Emergence of United States as a World Power

By the outbreak of war in Europe in 1914, the total long-term foreign investment in the United States had reached some 7.2 billion dollars, almost a fifth of the gross national product of the United States that year.[38] However, already by the early 1880s, the United States was the world's leading industrial nation commanding 29 percent of the world's total manufacturing output.[39] By that time, the output of its manufacturing sector had overtaken that of the agricultural sector, and the United States was clearly on a trajectory toward

---

[37]Raymond Vernon, *Sovereignty at Bay* (London: Longman, 1971).

[38]Only 1.3 billion dollars of the 7.2 billion dollars was in the form of foreign direct investment; the rest were portfolio investments. U.S. Gross National Product in 1914 was estimated at 38.6 billion dollars. Data from U.S. Department of Commerce, International Trade Administration.

[39]Barry E. Supple, ed., "Introduction to Part IV-- The Transformation of a Continent," in *The Experience of Economic Growth* (New York: Random House, 1963).

international economic dominance. Furthermore, with the war in Europe, inward foreign investments came to an abrupt halt in 1914.

In fact, the year 1914 was a watershed in the history of foreign investment in the United States. Commencement of the disastrous war in Europe caused the shifting of resources toward the war effort, and many foreign assets in the United States were sold under orders from the home country's government.[40] The U.S. entrance into the conflict in the April of 1917 accelerated the divestiture.

As the central antagonist of the war, all German-controlled properties and subsidiaries in the United States were seized outright by the U.S. government.[41] The U.S. Office of Alien Property Custodian expropriated German investments, shattering Germany's dominating position in the domestic chemical industry.

Though an ally, the British did not fare much better than the Germans. Although the British were not forced to sell their holdings, Britain had little choice but to liquidate about 70 percent of its total holdings in order to finance the exhausting war in Europe. Most of the sales of British controlled assets were at depressed prices because of the prevailing market conditions in a time of war. The British later partially rebuilt their holdings, but the portfolio portion was never again to reach its prewar dominant level. All in all, foreign-owned manufacturing assets plummeted to 2.2 percent of the total by 1919.[42]

40See Lawrence G. Franko, *The European Multinationals* (Stamford, Conn.: Greylock, 1976).

41The enabling legislation was the Trading with the Enemy Act of 1917.

42Lewis, *op. cit.*, p. 546.

Foreign direct investment rebounded somewhat during the prosperous 1920s, rising from about 900 million dollars in 1919 to about 1.4 billion dollars in 1929 to closely match the prewar figure of 1.3 billion dollars in 1914.[43] At the head of this investment surge were Swiss and Dutch corporations, and the German chemical industry proved irrepressible given their technological edge. In 1924, Bayer, BASF, and Hoechst combined to create I.G. Farben, soon after which the merged entity began operating in the United States and carved out almost 30 percent of the expanding domestic synthetic dyestuff market by the start of World War II.[44]

Table 6.1

Inward and outward investment in the United States, selected years, 1914-35

(U.S. $ billions)

	1914	1919	1929	1935
Total inward foreign invest.	$7.20	$4.38	$8.93	$6.33
Inward direct invest.	1.31	.90	1.40	1.58
Total outward U.S. invest.	3.51	16.94	28.67	25.13
Outward direct invest.	2.65	3.88	7.53	7.22
Net U.S. investment	-3.69	12.56	19.74	18.80

Source: U.S. Department of Commerce, International Trade Administration.

[43] Data from U.S. Department of Commerce, International Trade Administration.

[44] Franko, *op. cit.*

Nonetheless, World War I proved to be the turning point. After the war, the outward U.S. investment overshadowed the flow of foreign capital coming into the United States. By the beginning of the Great Depression, Americans claimed over five dollars of direct investment abroad for every dollar claimed by foreigners in the United States, and over the next five decades, America would remain a net capital exporter.

Whatever new inroads made into the U.S. economy by the Europeans in the 1920s were limited by the worldwide depression of the 1930s and reversed by World War II. War, once again, drastically reduced European holdings of U.S. assets.

The story of the previous war was repeated. With the entrance of the United States as a combatant following Pearl Harbor, the U.S. government confiscated the American assets of I.G. Farben and other German concerns. And, once more, the British had to divest their holdings in order to finance their war effort.[45] Even those foreign holdings that were not confiscated or sold off, with the line of communication cut off from their parent firms in Europe for so long, many operations and subsidiaries established during the prosperous part of the interwar period failed to survive the war. Only twelve continental European firms owned American manufacturing facilities at the end of hostilities in 1945, the same number as in 1913.[46]

---

[45]The British government, for example, forced Courtaulds, the textile concern dominating the American rayon market, to sell its assets in the United States. See Norman J. Glickman and Douglas P. Woodward, *The New Competitors: How Foreign Investors Are Changing the U.S. Economy* (New York: Basic Books, Inc., 1989), p. 30.

[46]*Ibid.*

The Postwar Period

Pax Americana

The United States emerged from World War II as the preeminent economic power in the world without peers and the leader of the Western alliance against international communism. The incredible devastation of the war left only the United States as the sole economic power capable of exporting capital abroad. A ravaged and capital-starved Europe was simply not capable, either from a financial or technological view, of undertaking any new significant investment activity in the United States or anywhere else.

From this unique set of historical circumstances, the United States fashioned a new international economic order based on liberal economic principles. Unimpeded flow of international investments was central to this order, and as the world's leading international investor, the United States had a keen interest in legitimizing foreign direct investment. Naturally, the United States refrained from enacting any new measure hindering inward foreign direct investment in its own soil, unless the investment somehow presented a security threat to the country in the context of the Cold War.

Both driven and constrained by the needs of national security, a major goal of the U.S. foreign economic policy in this period was making the world safe for international investments. To this end, with only a few limited exceptions, the United States proselytized to other nations the economic virtues of allowing foreigners to set up businesses in their territories and extending the same treatment they would accord to their own citizens.

Le Defi Americain

In the immediate postwar period, the ability to make investments abroad was a luxury enjoyed mostly by the United States; in fact, foreign direct investment was something of an American monopoly in the two decades following the end of World War II. The outward direct investment from the United States grew from about 8 billion dollars in 1945 to about 33 billion dollars by 1960.[47] The Europeans were slow in recovering from the devastation of war, while U.S. investments were vital to their recovery. And elsewhere, the United States was busy investing in petroleum and other raw materials industries in the Middle East, Latin American, and Asia.

Table 6.2
U.S. outward foreign direct investment
(U.S. $ billions)

Year	OFDI	% Change
1945	$8.4	--
1950	11.8	40.5
1955	19.3	63.6
1960	32.7	69.4

Source: Selected data from Pastor (1980), p. 205.

The principal carriers of these investments were the U.S.-based transnational corporations. They were the dominant providers of investment capital to Europe, Canada, Asia, Latin American, and other parts of the world. Buttressed by relatively cheap sources of capital and the state-of-the-art technical and managerial knowledge, they were almost unchallenged

[47]Pastor, *Congress and the Politics of U.S. Foreign Economic Policy*, p. 205.

in their voracious expansion abroad in the early years of the postwar period. The level of investment activities that resulted generated waves of alarm in many parts of the world.

The fearful, defensive reaction to U.S. investments in many parts of the developing world is well documented. However, the reaction in some parts of Europe was equally apprehensive. In particular, the French were convinced that the direct investments made by U.S. firms presented a genuine threat to their national sovereignty and destiny. In 1967 French journalist, J.-J. Servan-Schreiber, catalogued in his book, *Le defi americain,* the competitive advantage that enabled American firms to enjoy great success in the markets of Western Europe and sounded the alarm of impending threat to European political autonomy and economic security.[48]

Table 6.3

Share of outward foreign direct investment by home country, 1967

(U.S. $ billions)

Home country	1967
United States	$59.5
United Kingdom	17.5
France	6.0
Switzerland	4.3
Canada	3.7
Germany	3.0
Netherlands	2.3
Italy	2.1
Sweden	1.5
Japan	1.5
Other	6.9
Total	108.2

Source: United Nations, *Multinational Corporations in World Development,* ST/ECA/190 (1973), p. 139.

[48]See Servan-Schreiber's work, *The American Challenge.*

Indeed, the French President, Charles de Gaulle, had long been convinced that U.S. direct investment in Western Europe constituted a very real threat to French interests and grandeur.[49] He believed that U.S. investments were made possible because of the dollar-dominated world financial system that gave the United States unwarranted privileges; hence, he pressed for a gold system in order to counter American advantages.[50] The tireless French push for the consolidation of the European Community was also in part spurred on by the fear of American economic hegemony. However, the push for the common market had the effect of increasing U.S. investments in Western Europe.

The European Common Market

By the late 1950s, the European Common Market was beginning to take shape. Between 1959 and 1968, the members of the trading bloc ended all tariff restrictions on intra-community trade in industrial goods. Though they also lowered restrictions on some non-community goods, they kept or strengthened their barriers against others goods.

As the preferential trading zone became increasingly discriminatory against American producers, the U.S. headquartered transnational

---

[49]In fact, though subtle, the U.S. government constraints on European subsidiaries of American companies provided on occasions a channel for American interference in the policies of European nations. On more than one instance, the U.S. government used American subsidiaries to carryout its policy agenda at the expense of European policy objectives, especially those regarding the Middle East and Eastern bloc countries.

[50]De Gaulle surmised that the reserve role of the dollar as a major factor in U.S. outward investments. He believed that American monetary hegemony enabled the United States to simply print dollars and to buy up European assets; hence, if U.S. companies had to use a neutral medium of exchange, i.e., gold, Americans would quickly lose their dominance.

corporations sought ways to counter this growing protectionism. One solution was obvious: make direct investments in the common market and produce and sell inside the protective trade barrier.

Naturally, the outflow of investments from the United States increased dramatically following the formation of the common market in Western Europe. Between 1959 and 1964, the U.S. outward direct investment averaged over 3 billion dollars a year, with most of it going to Europe.[51] Interestingly, the U.S. investment in Western Europe was further stimulated by American access to a tariff-free trading zone, a point of entry provided by a provision in the Treaty of Rome that gave U.S.-owned subsidiaries who produced within the common market equal status to European Community firms. This loop-hole was a condition for American support of the treaty.[52]

Once established behind the barrier, the U.S. subsidiaries and operations in Western Europe often benefited from economic policies of local governments, such as policies ensuring them access to bank loans and other credit sources. The U.S. affiliates, in fact, managed to raise 55 percent of capital invested from local capital markets, often at subsidized, discounted rates. Further, direct subsidies were available from host governments in exchange for implementing strategic economic policies conceived by local authorities, policies such as regional developmental schemes. These subsidies and the cash available from local operations provided about 35 percent of the investment capital used by the U.S. affiliates in Europe. Only

[51]Figure complied from various issue of *Survey of Current Business*, U.S. Department of Commerce.

[52]Gilpin, *U.S. Power and the Multinational Corporation*, p. 108.

about 10 percent of the capital was sourced from direct dollar transfers from parent companies in the United States.[53]

Provided with the incentives of a large and united market as well as confronted with the barrier of high and uniform tariff wall, American firms leaped the wall and made investment on an unprecedented scale and volume in the European Community. By 1968, the U.S. subsidiaries and operations in Europe were selling some 14 billion dollars worth of goods a year, or about two and one-half times the amount of American exports to the common market.[54]

Table 6.4

Value of U.S. direct investments in Common Market,*
selected years, 1943-60

(U.S. $ millions)

Host country	1943	1950	1960
Germany	$513	$204	$1,006
France	167	217	741
Italy	85	63	384
Netherlands	60	84	283
Belgium-Lux.	66	69	231
Common Market	891	637	2,644

*Common Market came into existence in 1957.
Source: Selected data from Allan W. Johnstone, *United States Direct Investment in France* (Cambridge: The M.I.T. Press, 1965), p. 43

[53]Servan-Schreiber argued that this pattern of capital funding provided the Europeans with the instrument of their own economic subservience. Servan-Schreiber, *op. cit.*, p. 14.

[54]H.E. Ekblom, "European direct investments in the United States," *Harvard Business Review* (July-August, 1973), p. 17.

In fact, the outflow of investment was so heavy that it became a policy issue in the United States during the early 1960s.[55] In 1965, the U.S. government placed a comprehensive system of capital control which was intended to discourage or curtail investment outflows.[56] The result was that between 1965 and 1969, annual U.S. direct investment outflows stabilized around 5 billion dollars.[57]

Return of Foreign Direct Investment

Balance-of-Payments Problem

Indeed, the balance-of-payments problem facing the United States was an indication that, by the early 1960s, the overwhelming dominance of the United States in the world economy had begun to erode. As the U.S. government placed restrictions on outward investments, there was detectable strength in the inflow of direct investments coming into the United States from Europe. The new inflow reflected the economic recovery achieved in Western Europe and the regained ability of European-based transnationals to venture into business opportunities in the United States. This inflow was soon met with a policy response from the United States.

---

[55]The balance-of-payments impact of expanding foreign direct investment outflows from the United States was one of several international economic issues that confronted U.S. policymakers in the early 1960s. After all, direct investment alone was not the only contributor to the deficit.

[56]The control was placed on direct investments, bank loans as well as portfolio investments abroad.

[57]*Survey of Current Business*, various issues.

The U.S. policy response, however, was not restrictive, but rather promotive. Policy measures promoting European investment in the United States were initiated by the executive branch and were justified as a way of addressing the balance-of-payments problem. In the early 1960s, the Commerce Department, in conjunction with the National Association of State Development Agencies, undertook a major effort in Europe to promote inward direct investment in the United States; and the Kennedy administration launched a federal program to promote foreign investment in the United States in its effort to address the imbalance in payments issue.[58]

In 1961, President John F. Kennedy authorized a program called "Invest in the U.S.A." as a way to address the balance-of-payments problem through encouraging the inflow of long-term capital into the United States. The program was overseen by the Office of International Finance and Investment (later the Office of Foreign Direct Investment) of the Bureau of International Commerce of the Commerce Department, and its goal was to facilitate inward direct investment by providing data on markets, financing, and legal matters to prospective foreign investors.[59]

The program did not have any discernable impact on the flow of inward investments; and, in 1963, the Kennedy administration established a task force chaired by the Undersecretary of the Treasury, Henry Fowler-- with representatives from the State and Treasury Departments, business groups, and the financial community-- to "design a new and positive program to

---

[58]*National Journal*, November 24, 1973, p. 1755.

[59]*Ibid.*

promote overseas sales of securities of U.S. companies."[60] By mid 1964, this task force issued a report which the Treasury Department utilized as the basis for a bill it drafted for the White House. The White House, now occupied by President Lyndon Johnson, sent the draft bill to Congress where it emerged as the Foreign Investors Tax Act and was signed into law by the president in October 1966.[61]

With the exception of the "Invest in the U.S.A." program and the Foreign Investors Tax Act, however, neither the White House nor Congress showed much interest or concern toward inward foreign direct investment as an issue in itself. These promotive measures were the extent of policy interest in inward foreign direct investment by the policymakers in the White House and Congress during this period when most Americans still felt confident about U.S. economic prowess and appreciated that economically strong allies were needed against international communism.

Turn of the Tide

Even without the encouragement of the U.S. government, however, the reality was that the tide was turning in the direction of investment flows by the mid 1960s. From 1966 to 1970, the rate of growth of European direct investment in the United States exceeded that of U.S. direct investment in Europe for the first time since World War I.[62] After two decades of near

---

[60]A case study of the legislation can be found in David Price, *Who Makes the Laws?* (Cambridge, Mass.: Schenkman Publishing Company, 1972), pp. 151-65.

[61]*Ibid.*

[62]Ekblom, *loc. cit.*

American monopoly in international investment, the Europeans finally reemerged as major investors on the world scene.[63]

In fact, the 1960s were a high point of internationalization of European businesses. Between 1968 and 1970, for instance, almost half of all French transnational firms were created. The comparable numbers for new British and German firms were 29 percent and 39 percent, respectively.[64] And, for the first time, the Japanese transnationals emerged to join their European counterparts in the search for investment opportunities in the United States. Even firms from developing countries joined European and Japanese firms in the quest for globalization.[65] The stage was set for the return of inward foreign direct investment as, once again, an important economic phenomenon in the United States. Indeed, by the mid 1960s, a counterrevolution was underway.[66]

---

[63]Of course, in this period, a great deal of attention was paid to the flow of investments from developed countries to the developing world because some observers believed that these investments were new forms of colonialism. However, the central determinants of foreign direct investment tend to be market opportunities and stability, and these factors contributed to the flow of investments from developed countries to other developed countries where these conditions can be met. The importance of profits is obvious, but the latter, stability, means not only political stability but also a framework of policies geared to sound fiscal and monetary management of the national economy as well as an environment friendly toward foreign investment.

[64]James Vaupel and Joan Curhan, *The World's Multinational Enterprises* (Boston: Graduate School of Business, Harvard University, 1973).

[65]For example, National Iranian Oil Corporation of Iran and Petrobras of Brazil.

[66]Rainer Hellman, *The Challenge to U.S. Dominance of the International Corporation* (New York: Dunellen, 1970), p. xii.

CHAPTER SEVEN

Turn of the Tide

In the 1970s, inward foreign direct investment once again became a significant foreign economic policy issue in the United States after a long period of dormancy. Coinciding with international economic crises, the rapidly accelerating globalization of markets, and the declining American economic competitiveness, the surge of foreign direct investments coming into the United States during this period caused the elected policymakers in the White House and Congress to revisit the long forgotten inward foreign direct investment policy.

This chapter, the first of four chapters that constitute the substantive heart of the present study, explores the international problems of the tumultuous period marked by oil price shocks and deep recessions. It describes how these larger structural factors set the stage for the reemergence of inward foreign direct investment as a political issue in the United States during the 1970s. It examines the economic circumstance leading to the renewed political interest in inward foreign direct investment and explores how international economic forces impacted politics during one of the most important inflection points in the postwar U.S. economic history.

The Return of Foreign Capital

The Setting

The containment of communism was the core foreign policy objective of the United States from the late 1940s onward; however, by the early 1970s, the concept of *detente* had been incorporated into U.S. policy toward the main communist rival, the Soviet Union. While the global security structure of the Cold War era was beginning to shift somewhat, things were changing even faster in the international economic structure. During the early 1970s, the postwar international economic system was undergoing a sea-change.

By the mid 1970s, the U.S. sponsored Bretton Woods international monetary system was in shambles. It was also apparent that the liberal ideal of a world economy organized in terms of a self-regulating market was on the defensive as the achievements of successive rounds of trade liberalization were being undermined by the persistence and spread of various forms of non-tariff trade barriers. Though international interdependence was growing with ever increasing levels of trade and investments, international economic cooperation-- never perfected during the postwar era-- was becoming increasingly problematic in many areas as the U.S. hegemony began to ebb.

If the economic foundation of U.S. leadership began to show tiny cracks by the early 1960s, America's declining competitiveness became plainly obvious by the early 1970s. The status of the dollar reflected the United States' weakened trade position and slowing productivity: The unfavorable trade imbalance and the slow pace of U.S. productivity growth placed severe stress on the dollar, culminating in the closing of the "gold window" by the United States in 1971.[1]

By 1977, the U.S. portion of international trade had dropped from 18.4 percent in 1950 to 13.4 percent.[2] More revealingly, America's share of the world's merchandise exports had plummeted from a height of almost 30 percent in the early 1950 to about 13 percent by the late 1970s.[3] In fact, its slice of the world's manufacturing output had declined to 44 percent in 1977 from a commanding 62 percent in 1950.[4]

These changes at the macro level were driven by shifts and dramatic transformations in market shares by firms. By the mid 1970s, many U.S. businesses had lost or were losing their competitive advantage. Once unchallenged, they now faced fierce competition from foreign firms in the global marketplaces. In many industries, American firms were being successfully challenged by increasingly better managed foreign companies with innovative products and new techniques. In fact, after years of nurturing by supportive national governments and intra-national mergers and competition, by the late 1960s and early 1970s, many European and

---

[1]In the summer of 1971, the United States unilaterally announced that the dollar would be no longer be convertible into gold or other primary reserve assets.

[2]Of course, these are relative figures. The world trade grew phenomenally since the 1950s, continuously outperforming the growth in world GNP. See David Lake, "International Economic Structures and American Foreign Economic Policy," *World Politics*, Vol. 35 (July 1983), p. 541.

[3]Martin Feldstein, ed., *The American Economy in Transition* (Chicago: National Bureau of Economic Research, 1980), pp. 193 & 196.

[4]*Ibid.*, p 191.

Japanese corporations had acquired sufficient capability and confidence to enter and challenge American corporations in their own home market.[5]

Reversal of Investment Flows

With the decline of U.S. competitiveness, the tide of direct investment began to turn in the mid 1960s. By the early 1970s, inward foreign direct investment became, once again, a significant economic phenomenon in the United States.

Table 7.1

Inward foreign direct investment in the United States, 1970-80

(U.S. $ billions)

	Book value year-end	Annual increase	Percent change
1970	$13.27	--	--
1971	13.66	$0.39	2.9
1972	14.87	1.21	8.9
1973	20.56	5.69	38.3
1974	25.14	4.59	22.3
1975	27.66	2.52	10.0
1976	30.77	3.11	11.2
1977	34.60	3.83	12.4
1978	42.47	7.88	22.8
1979	54.46	11.99	28.2
1980	68.35	13.89	25.5

Sources: Various issues of *Survey of Current Business.*

The increase was huge not only in absolute terms, but in relation to the size of the gross domestic investment as well as the U.S. outward direct investment. As late as 1970, the ratio of the cumulative stock of outward

[5]"The New Competition From Foreign-Based Multinationals," *Business Week,* July 7, 1973.

direct investment by Americans to inward direct investment by foreigners was about 5.2. By 1980, the ratio had declined to 1.4.[6]

Table 7.2
Foreign direct investment in the United States, by sector, 1970-80

(U.S. $ billions)

	Mfg.	Petrol.	Trade	Finance	Ins.	R. Estate	Other
1970	$6.14	$2.99	$0.99	*	$2.26	n/a	$0.89
1971	6.72	3.14	0.51	*	2.55	n/a	1.50
1972	7.23	3.23	0.51	*	2.44	n/a	0.86
1973	8.23	4.79	3.12	$0.91	1.91	$0.60	1.00
1974	10.39	5.61	4.39	1.43	1.30	0.81	1.23
1975	11.39	6.21	4.84	1.52	1.64	0.78	1.29
1976	12.62	5.92	6.12	1.83	2.11	0.80	1.37
1977	14.03	6.57	7.24	2.23	2.32	0.85	1.36
1978	17.20	7.76	9.16	2.46	2.77	1.16	1.95
1979	20.88	9.91	11.56	3.43	4.15	1.82	2.72
1980	25.16	12.36	14.30	5.00	5.37	3.07	3.10

Source: *Survey of Current Business*, August, 1982.

As for the American share of the total stock of global investments, in the period 1974-79, the U.S. portion of all inward foreign direct investment received by the major OECD countries increased to about 26.7 percent, compared to only 2.6 percent during 1961-67 and 11.4 percent during 1968-73.[7] Another indicator of the surge and increasing prominence of inward foreign direct investments in the American economy by the 1970s was the growth of employment by affiliates and subsidiaries of foreign companies. By 1979, approximately 1.6 million workers were employed by private, non-bank

[6]Figures derived from data presented in various issues of *Survey of Current Business*.

[7]OECD, *Recent International Direct Investment Trends* (Paris: OECD, 1981), p. 41.

affiliates and subsidiaries of foreign firms.[8] In the manufacturing segment of the economy, these affiliates and subsidiaries employed over 900,000 workers, or almost 5 percent of the manufacturing work force.[9]

Table 7.3

Distribution of inward direct investment flows, selected period, 1961-78

(percentage)

	1961-67	1968-73	1974-78
United States	2.6	11.4	26.7
Japan	2.0	11.7	1.2
Germany	21.3	16.4	14.7
France	8.2	8.2	15.2
United Kingdom	9.7	7.4	6.1

Source: OECD, *International Direct Investment Trends*, 1981.

The dollar devaluations of the early 1970s meant the relative decline in the cost of American land, labor, raw materials, and production. The currency realignments made many U.S. firms and assets very attractive to foreign investors, particularly the large transnational corporations headquartered in Western Europe and Japan. In fact, investing in the United States was made compelling for many of these foreign firms by the reality that their successful products were being priced out of the U.S. market while the United States was becoming increasingly protectionist.

Not surprisingly, these large transnational corporations were the source of much of this increase in foreign direct investment in the United States. These increasingly sophisticated European and Japanese companies possessed firm-specific assets that gave them a particular advantage in some

[8]Data are from various issues of *Survey of Current Business* (Washington, D.C.: Department of Commerce/Bureau of Economic Analysis).

[9]OECD, *Recent International Direct Investment Trends* (Paris: OECD, 1981), pp. 20-21.

aspect of management and/or technology over their American counterparts and were at the vanguard of the new wave of investments. Their investment in the United States mirrored the earlier, highly successful example of American transnational corporations' global strategy for production and sales.

The Impact of Petrodollars

Many have argued that the energy crisis of the 1970s marked the end of an era of undisputed U.S. economic dominance. Certainly, the oil price shocks of the 1970s dramatically underscored how the fundamental changes that were taking place in the global economy were affecting the United States. Whatever the extent of their larger effects, the price hikes were important catalysts in increasing the volume of foreign direct investment in the United States.[10]

Table 7.4

Investment flows from Middle Eastern members of OPEC into the United States, 1974-78

(U.S. $ millions)

	1974	1975	1976	1977	1978
U.S. gov't. securities	$3,176	$4,368	$4,857	$4,676	-$2,504
Corporate securities	216	2,137	2,221	2,127	1,472
Bank liabilities	1,979	1,133	1,796	352	-605
Other liabilities*	581	1,422	2,671	563	145
Direct investment*	77	6	-15	-13	100
Total	6,029	9,066	11,530	7,705	-1,392

*Excludes Bahrain and Oman

Source: Derived from U.S. Treasury Department data presented in Benjamin J. Cohen, *In Whose Interest?* (New Haven: Yale University Press,1986), pp. 124-5.

---

[10]The first crisis was the result of members of OPEC cutting back production and instituting embargoes in response to the 1973 Arab-Israeli war. The second crisis was the result of the Islamic revolution in Iran.

For one thing, the oil price hikes caused a rapid and large scale redistribution of wealth to the Organization of Petroleum Exporting Countries (OPEC). This led to a flood of investments in the United States by suddenly cash-rich oil-producing countries led by Saudi Arabia, Kuwait, and, to a lesser extent, the United Arab Emirates.

Table 7.5

Investment flows from Middle Eastern members of OPEC into the United States, 1979-83

(U.S. $ millions)

	1979	1980	1981	1982	1983
U.S. gov't. securities	$2,455	$9,173	$14,052	$7,486	-$6,537
Corporate securities	1,195	3,255	2,797	-235	-1582
Bank liabilities	4,233	-897	-2,551	425	375
Other liabilities*	-1,623	1,453	-647	-2,177	-1,340
Direct investment*	16	212	2,666	708	-4
Total	6,276	13,196	16,317	6,207	-9,088

*Excludes Bahrain and Oman

Source: Derived from U.S. Treasury Department data presented in Cohen, *loc. cit.*

More importantly, the massive increase in global liquidity caused by the circulation of "petrodollars" in international capital markets accelerated and intensified the flow of non-OPEC foreign investments into the United States. While there can be no clear accounting of the petrodollar-driven investments made in the United States during this period, it cannot be disputed that the increased liquidity associated with the oil shocks facilitated a massive increase in the volume of investments coming into the United States.

In the short-term, there were two distinct phases in the movement of OPEC-related investment funds. With each oil price shock there was, first, a heavy investment inflow generated by the swelling OPEC profits after oil prices were raised and then, gradually, some outflow again as the surplus funds made their way elsewhere. Peaks in the inflow were reached in 1977 and 1982, and most of these investments were made by entities linked to the governments of OPEC members rather than by private parties.

While the majority of these investments were portfolio in nature, there were some highly visible direct investments by OPEC members, including the controversial 2.5 billion dollar acquisition of Santa Fe International Corporation by Kuwaiti government-owned Kuwait Petroleum.[11] However, these direct investment were more notable for their visibility than their dollar value.

More significant in the long run, the financial consequences of the two oil shocks accelerated the deeper changes that were taking place in the international economy. For one thing, the recycling of petrodollar surpluses in the 1970s and early 1980s stimulated the development of global financial markets capable of handling massive, cross-boarder capital flows.[12]

Combined with the computerization of financial markets, the reduction of costs of transporting goods and people, and the accelerated removal of many legal barriers to both inward and outward financial flows,

---

[11]The acquisition was completed in 1981. The Kuwait Petroleum Company, a firm wholly owned by the government of Kuwait, paid 2.5 billion dollars for Santa Fe International, an American company specializing in oil exploration and other ventures. Apart from the fact that the acquiring firm was a state-owned firm of an OPEC government, the transaction raised a red flag because of concern about the transfer of defense related technology. A subsidiary of Santa Fe, C. F. Braun, was a contractor for a U.S. government nuclear facility. In late 1981, CFIUS cleared the transaction after the Energy Department negotiated a deal to keep the subsidiary's technology out of Kuwaiti hands.

[12]In the United States, for example, almost all capital controls were removed in 1973-74, reflecting the need to open the capital markets for the international financial intermediation of OPEC surplus dollars.

the newly enlarged global capital markets had the effect of dramatically reducing the cost of international transactions. This made the undertaking of foreign direct investment all that much easier. This in turn, of course, made foreign direct investment a more profitable undertaking.

Table 7.6

Estimated size of international bank lending, 1973-83

(U.S. $ billions)

Reporting year**	Foreign currency claims	Domestic currency claims	Total claims	Net* int'l. bank lending
1973	$247.6	$49.0	$296.6	n/a
1074	282.5	78.4	360.8	$220.0
1975	34.9	99.4	442.2	260.0
1976	418.4	129.6	549.5	330.0
1977I**	503.1	153.9	657.1	405.0
1977II**	514.3	175.5	689.8	435.0
1978	659.7	233.5	893.2	530.0
1979	828.9	282.1	1,111.0	665.0
1980	980.0	341.9	1,321.9	810.0
1981	1,124.8	425.4	1,550.2	945.0
1982	1,135.9	558.6	1,694.5	1,020.0
1983I**	1,186.7	570.4	1,757.1	1,085.0
1983II**	1,527.3	570.6	2,097.9	1,240.0

*Total claims net of BIS estimates of interbank deposits.
**Include reporting banks in Europe, Canada, Japan, and the United States, and offshore operations of U.S. banks in the Bahamas, Cayman Islands, Panama, Hong Kong, and Singapore. Austria, Denmark, and Ireland are not included in Europe until 1977II; Finland, Norway, and Spain are not included until 1983II.

Source: Selected from Bank of International Settlements (BIS) data presented in Cohen, *op. cit.*, p. 23.

Summary

This chapter explored what caused inward foreign direct investment to, once again, became a significant political issue in the United States in the

1970s. It described briefly how the coincidence of international economic crises, the rapid globalization of markets, and the decline of U.S. economic competitiveness contributed to the surge of foreign direct investments coming into the United States during this period. It examined some of the international problems of the tumultuous period marked by oil price shocks and deep recessions and described how these larger structural factors set the stage for the return of inward foreign direct investment in the United States.

The next chapter will explore how this sudden surge of investments coming into the United States caused the elected policymakers in the White House and Congress to revisit the long forgotten inward foreign direct investment policy. If the surge of inward foreign direct investment in the early 1970s was one of the signs that marked the end of an era for the United States economically, it also produced political consequences that reshaped an important aspect of U.S. foreign economic policy. The chapter coming up will concentrate on the more important task of analyzing the policy struggle among these elected officials, the struggle that set the mold for the post-Cold War U.S. inward foreign direct investment policy.

CHAPTER EIGHT

Creation of CFIUS

Given the international problems of the tumultuous 1970s and the macro and microeconomic factors that set the stage for the surge of direct investments coming into the United States during this period, this chapter explores how this sudden inflow of investments caused elected officials in Congress and the White House to revisit the long neglected inward foreign direct investment policy. More specifically, this chapter describes how the "revived" U.S. inward foreign direct investment policy was shaped by the political needs of the elected policymakers. It details how these policymakers, constrained by the incentives and disincentives of the politics of structural choice, laid the foundation of the present day regulatory mechanism overseeing incoming direct investment.

Spurred on by newspaper headlines and the public outcry about the "invasion" of America, these policymakers first had to discover what rules and laws existed already targeting inward foreign direct investment as well as determine the true magnitude and nature of the investment capital coming into the United States. The outcome of this discovery process and the regulatory measures that soon followed it reveal that what critically influenced the scope and shape of the revitalized U.S. policy toward inward foreign direct investment was the complex interaction between the officials in the White House and Congress. While the president, fearing a protectionist backlash as well as for ideological and political reasons, sought to limit new, congressionally mandated restrictions on inward foreign direct investment, the interested policymakers in Congress pursued a high-profile policy agenda seeking a more far reaching regulation of inward investments.

The most significant product of this interaction was the creation of the Committee on Foreign Investment in the United States (CFIUS). CFIUS was, in effect, a compromise "institutional solution" reconciling presidential goals and congressional concerns: While the president managed to keep the newly created machinery of regulation under White House leadership, CFIUS represented the crucial political concession assuring those policymakers in Congress that the inward investment issue would receive more attention from the White House and be subject to increased congressional scrutiny.

The Policy Reaction

Even prior to the oil price shocks, the increased levels of direct investment by foreigners had caught the attention of policymakers already troubled by the country's balance of trade problems-- particularly with respect to Japan which started to accumulate a large surplus *vis-a-vis* the United States.[1] However, clearly, what jolted the policymakers to take stock of the situation was the flood of petrodollar investments coming into the United

[1]The surge of Japanese real-estate investments in Hawaii in 1972 and 1973 gave rise to loud complaints about a second Pearl Harbor.

States following the first oil shock. Their critical examination of the investment issue was made urgent by America's rude awakening to its vulnerabilities in the international political economy.

With the OPEC countries imposing a politically motivated embargo on oil exports to the United States, indeed, there was a swell of public anger which was only exacerbated by the seeming flood of Arab investments coming into the United States following the initial oil shock.[2] Ordinary citizens needed no reminding who tripled the price of oil and was the cause of long lines at gasoline stations. To many people, it was clear by the OPEC embargo that Arab governments had the will, if not the capability, to pressure the United States economically in pursuit of their national interests.

National political leaders were no less concerned about the rapid inflow into the country of capital controlled by governments that had just engaged in "economic war" against the United States and whose actions have aided in producing a profound global recession. Many in Congress were especially anxious that the investments made possible by these extraordinary earnings were being driven by some ulterior political motives to do further damage to the U.S. economy. Their fear of the potential danger posed by these investments was deepened by even the most conservative early projections of OPEC earnings suggesting that OPEC's profit accumulations could end up being in the hundreds of billions of dollars.[3]

---

[2]The public was bombarded with alarmist reports. Even best-selling novels (e.g., *The Crash of '79* by Paul E. Erdman) were being published featuring hair-raising specter of depression or worse as a result of OPEC manipulation of their oil wealth.

[3]Department of Treasury's forecast was for a minimum of 200 to 250 billion dollars (inflation adjusted) by 1980. See Benjamin J. Cohen, "Mixing Oil and Money," in J. C. Hurewitz, ed., *Oil, the Arab-Israel Dispute, and the Industrial World* (Boulder: Westview Press, 1976), pp. 197-8.

Troubled for the first time in the postwar period about the potentially negative impact of inward foreign direct investment on U.S. national interests and quite mindful of the palpable fear and resentment among the electorate about the flood of foreign money pouring into the country, policymakers in Congress, with White House complicity, added a new layer of regulatory measures on top of a veritable patchwork of preexisting policies targeting inward foreign investment that have been lying more or less dormant since the prewar years. The main result of this new policymaking activity was that what amounted to U.S. policy toward inward foreign direct investment became highly data-conscious and assumed a greater degree of coherency by the late 1970s.

Beyond the impact of popular political sentiment, however, this policy activism was more directly the result of the political interaction among elected policymakers in government. While there was a deep public anxiety about the new unsettling realities of the international economy, voters' concerns about foreign direct investment were diffuse. As it is often the case in public policymaking in advanced industrial democracies, "policy entrepreneurship"-- politicians' attempt to extract political advantage out of diffuse interests-- was the key to the policy transformation. It was the elected officials who initiated the policy review and carried through the policy revision.

Naturally, these officials were not of one mind about what was at stake concerning inward foreign direct investment; they had divergent views on the issue. They were divided by ideology, partisan politics, and a host of other factors routinely dividing elected officials of any industrial democracy. However, one of the strongest divisions coalesced around the needs and institutional dynamics of the presidency and Congress.

Clearly, it was the policymakers in Congress who most wanted to revitalize and revamp the long dormant, hodgepodge of regulations targeting foreign direct investment in the United States. Though they did not always have ready access to information needed to take sound policy positions, they had very little to lose, but much to gain, politically in taking the populist position on the investment controversy. Indeed, they had much political incentive to draw attention to the issue as an urgent matter of national security and to "grandstand."[4]

While the White House was mindful of the new vulnerability of the United States to international economic forces and aware of public's antipathy toward inward foreign investment, the president did not show the sense of panic or outrage that many in Congress expressed about the surge of incoming investments. Indeed, given its better sense of how much foreign capital was really coming into the country, the White House was more concerned about not jeopardizing the inflow of these investments and its rather delicate relationship with non-radical Arab governments, particularly the government of Saudi Arabia which was "repatriating" a large portion of its oil proceeds back into the United States in the form of U.S. Treasury obligations. Hence, while privately worried about the potential danger that these investments could indeed be turned into a source of leverage for foreign interests in the U.S. body politics, the president was hesitant to accede to proposals by those in Congress to restrict the inflow of foreign capital.

Nonetheless, the White House could not simply ignore the strong public opinion against inward foreign direct investment and the concerns of

---

[4]Grandstanding helps a legislator to the extent that it pleases voters and give the member favorable exposure. See David R. Mayhew, *Congress: The Electoral Connection* (New Haven: Yale University Press, 1974), pp. 43-79.

the policymakers in Congress roused by it. Given that much of the authority enjoyed by the president in the foreign economic policy arena is delegated power from Congress, the White House had to consider congressional views and requirements concerning the issue. In fact, the president had to cooperate with the policy activists in Congress in order to preserve and effectively exercise executive powers. What new regulations concerning inward foreign direct investment that were passed then resulted from the give-and-take between the elected policymakers in the White House and Congress during a time of intense public awareness of and sensitivity toward foreign investment activities.

In the policymaking process, the White House was interested in, at least, retaining executive control over the new regulatory framework called for by Congress if it could not have its way in determining the nature of the framework itself. More than anything, it did not want to cede political control over a "new" area of foreign economic policy to Congress. The president and his aides sharply disagreed with and actively resisted many congressional policy proposals on substantive grounds: As already mentioned, the White House wanted to maintain good relations with certain member states of the OPEC as well as prevent any confrontation with other OECD governments that might respond to restrictive U.S. policy by retaliating against U.S. investment activities in their respective jurisdictions.[5] Nonetheless, if the White House could not prevail over Congress on the substantive aspect of policy, the course of White House action in its bargaining with Congress clearly shows that the president placed his first

[5]No doubt, this "foreign policy" nature of the investment issue is something that neostatists would focus on as the most salient feature of the U.S. inward foreign direct investment policy.

priority on securing the maximum level of executive leadership in a "reactivated" area of foreign economic policy.

The interested policymakers in Congress were not entirely unsympathetic to the president's desire to preserve executive policy control or his substantive policy concerns. What they sought with their policy activism was president's attention on an issue that they considered important to the national interest and some valuable exposure for themselves as issue leaders given the great public (voter) interest in foreign investment activities in the United States. They had neither the political incentive nor the resources to take policy control away from the White House.

In fact, considering that the president has, to some degree, agenda control and can initially control hidden information, those in Congress lacked the thoroughgoing knowledge of the nature and extent of inward investment activities needed to impose their own policy preference on the president. They could, however, propose policy initiatives that were sufficiently objectionable to the White House so that the president would have to respond in some fashion to meet their concerns and requirements halfway. Furthermore, so long as they possessed the ability to control the selection or deal out *ex post* rewards and punishments in the regulatory process, they could make additional claims or demands on the White House, if required.

The aim of those in Congress was then to have the executive branch pursue at least some aspects of their policy concerns. Here, their *modus operandi* was to delegate power to the president– by rewriting (or threatening to rewrite) laws and creating (or, again, threatening to create) new regulatory rules, guidelines, procedures, etc. As policy entrepreneurs, their end goal was to garner favorable (hopefully) publicity for themselves before the voters.

The policy compromise was then struck at this meeting point of the president's attempt to maintain maximum level of control over his delegated powers in foreign economic policymaking on the one side and the combination of minimal congressional faith in the executive bureaucracy and congressional delegation of power to the president on the other.

The Policymaking Process

Congressional Ferment

The initial congressional effort to restrict foreign direct investment in the United States did not spring up suddenly. Rather, the pressure to do something about the increasing foreign holdings in the United States built up steadily in the rising number of constituent letters denouncing the "sell out" of America. Indeed, the dollar devaluation of 1971 took sometime to have a readily visible effect on foreign investment behavior. However, by the second dollar devaluation in February of 1973, a number of highly visible foreign acquisition of American assets had taken place and a steady stream of anti-foreign investment editorials was appearing in newspapers around the country as the pace of inward foreign investment quickened in the United States.

Reacting to these newspaper editorials and the loud grumbling in their districts about the "invasion" of the country by rich foreigners in the wake of the dollar devaluations, many lawmakers in Congress began to introduce bills to address voter anxiety. These bills ranged from prudent to xenophobic. Either way, the various proposals introduced in Congress tended to be restrictionist in nature. One way or another, most of the bills called for a some kind of limitation on foreigners investing in the United States.[6]

Representatives John Dent and Joseph Gaydos on June 25, 1973 introduced the first of Congress's many restrictionist bills addressing public's uneasiness about the sale of American assets to foreign interests. It was a serious proposal, and it was introduced as an amendment to the Securities Exchange Act. The bill, H.R. 8951, proposed to "protect American corporations and workers from foreign control."[7]

The proposed amendment had far reaching objectives. If the bill had passed into law, it would have prevented foreigners "from acquiring, directly or indirectly, more than 5 percent of voting securities, or more than 35 percent of the non-voting securities" of any U.S. company whose securities were registered with the Securities Exchange Commission.[8] In addition, although it not to be retroactive in its application, it would have blocked any foreign entity that already possessed over 5 percent of the voting stake in a U.S. corporation from accumulating any more shares.[9] The bill was subsequently reintroduced with other cosponsors in November as the Foreign Investors Limitation Act (H.R. 11265).[10]

---

[6]This chapter's account of congressional policy initiatives and the White House reaction to them has benefited greatly from Pastor's *Congress and the Politics of U.S. Foreign Economic Policy*.

[7]*Ibid.*, p 224.

[8]*Ibid.*

[9]*Ibid.*

[10]For details of this bill, see Mina Gerowin's "U.S. Regulation of Foreign Direct Investment: Current Developments and the Congressional Response," *Virginia Journal of International Law*, Vol. 15, No. 3 (Spring 1975), pp. 634-46.

In short, the Dent-Gaydos bill was a far reaching, highly restrictive-- but serious-- legislative proposal that, at minimum, encouraged further debate on the inward foreign direct investment issue in Congress. More importantly, it was a bill that had enough support in Congress to incite a reaction from the president. It was, in fact, a provocative bill that immediately caught the attention of the White House.

White House Reaction

If Richard Nixon's White House did not seem too alarmed about the increasing level of investments coming into the United States or the negative public reaction to it, it became deeply concerned when Congress became interested in the inward foreign investment issue as a policy concern. Indeed, the introduction of the Dent-Gaydos bill in the House of Representatives served as a kind of alarm that roused the administration to take notice of the investment issue as a serious policy matter.[11]

Being a Republican administration, the Nixon White House was predisposed to the traditional Republican foreign economic policy goal of removing regulatory and tax hurdles impeding free international capital movement. The president was, in fact, very interested in ending U.S. controls on outward foreign investment and was politically committed to this policy objective.[12] Of course, to avoid being accused of having double standards, the flip side of this policy objective was eliminating U.S. regulatory measures that might hinder or discourage investments coming into the

---

[11] *Ibid.* p. 632.

[12] See Richard S. Frank, "Economic Report/Improved balance-of-payments prospects end to controls on foreign investment," *National Journal*, June 2, 1973, pp. 809-15.

United States.[13] Hence, White House's initial reaction to growing sentiment in Congress to do something about the increasing level of inward foreign investments was to try preempting Congress from defining inward foreign direct investment as a serious policy problem worthy of legislative attention.

Unfortunately for the White House, many in Congress had already identified the issue as something that required legislative action. Sensing the irrepressible activist mood in the Democrat-dominated Congress, Nixon's senior aides advised the president that he needed to take the initiative on the inward foreign direct investment issue if he were to prevent things from getting out of hand in Congress.[14] Indeed, the president appreciated the fact that, to effectively exercise executive leadership in this reactivated area of U.S. foreign economic policy, he had to introduce policy initiatives of his own to counter the congressional ones he found objectionable.[15] To this end, in June 1973, President Nixon designated the cabinet-level Council on International Economic Policy (CIEP, now defunct) as the focal point of the White House effort to take charge of the policy issue.[16]

---

[13]On January 29, 1974, the White House, together with the Commerce and Treasury Departments and the Federal Reserve Board, announced the termination of controls over foreign investment and lending procedures. The three programs designed to control the flow of American capital abroad to be eliminated were the following: Treasury's interest equalization tax, imposed in 1963, on purchase of stocks and bonds of foreign companies by American interests; Commerce Department controls, instituted in 1968, on direct investment by U.S. corporation; and Federal Reserve Board's voluntary foreign credit restraint program, instituted in 1965, governing bank lending to foreign businesses.

[14]Personal interview with a former aide to President Nixon.

[15]*Ibid.*

[16]CIEP was nominally chaired by the president with the secretaries of State, the Treasury, Agriculture, Commerce, Labor, Defense, and Transportation, and the director of the Office of Management and Budget (OMB), the chairman of the Council of Economic Advisers (CEA), and the Special Representative for Trade Negotiations (STR) as members. CIEP, as originally envisioned, was to function as a top-level coordinator of foreign economic policy, but that

With great haste, CIEP's executive director, Peter Flanigan, and his assistant, David Gunning, created an interagency task force to examine and evaluate the existing policy on foreign investment in the United States.[17] Headed by a CIEP assistant director, John Niehuss, the members of the task force consisted of representatives from the State, Treasury, Commerce, Labor, Agriculture, and Justice departments as well as several other government agencies.[18]

Ostensibly, the CIEP task force was charged with the responsibility of analyzing what was at stake for the country with regard to the flood of foreign money coming into the United States. It was also charged with forming policy alternatives for the president. However, its more important task was to deal with the congressional interest in the issue.

Interbranch Dynamics

Meanwhile in Congress, the interest in foreign investment in the United States as a regulatory issue was spreading wider. Representatives Dent and Gaydos were only the first to introduced measures to address concerns about the increasing levels of foreign money coming into the country. Other lawmakers were also eager to claim the issue as their own and make their legislative mark.

By the late 1973, a number of important subcommittees chairmen in both the House and the Senate had become involved. At first uninformed

---

concept never took hold. Rather, it served more as a last resort coordinator on specific issues or newly emerging policy areas such as inward foreign direct investment.

[17]See John Niehuss, "Foreign Investment in the United States: A Review of Government Policy," *Virginia Journal of International Law*, Vol. 16, No. 1 (Fall 1975), pp. 65-102.

[18]*National Journal Reports*, August 31, 1974, p. 1312.

about the steps being taken by the White House, Representative John Culver started to hold hearings on the subject before his Subcommittee on Foreign Economic Policy of the House Foreign Affairs Committee. In the Senate, Daniel Inouye, the chairman of the Subcommittee on Foreign Commerce and Tourism of the Senate Commerce Committee, and Adlai Stevenson III, the chairman of the Subcommittee on International Finance of the Senate Committee on Banking, Housing, and Urban Affairs, also started their own hearings.

Chairing subcommittees charged with overseeing foreign economic affairs, the three lawmakers were motivated to hold hearings for several reasons. First, they were motivated by their lack of knowledge about the true extent of foreign holdings in the United States. They also wanted to better understand the existing U.S. laws and regulations targeting inward foreign investment.

In addition, being generally pro-market in their outlook as responsible chairmen of "internationalist" subcommittees, they were propelled to hold their hearings by the fear of protectionist backlash against free flow of trade and investment. As Representative Dent's exclusionary bill speeded up White House's attempt to preempt congressional intrusion into president's handling of foreign economic policy, it also hastened the three chairmen to hold hearings in their own committees in order to claim the foreign direct investment issue as their own and move it into a more market-friendly policy environment.

Senator Inouye's Subcommittee on Foreign Commerce and Tourism was the first to hold hearings. The committee considered Senator Inouye's bill, S. 2840, which would authorize a three year, two million dollar study on foreign investments in the United States.[19] Culver and Stevenson's committees soon followed with their own hearings and agendas.

While these congressional hearings were underway, by December 1973, the cabinet-level executive committee of CIEP met at the White House and considered the report of its task force on inward foreign investment. The main finding of the task force was predictable: The task force reported that the existing policy-- defined as "minimal regulation of foreign investment applied on a non-discriminatory basis"-- was adequate to safeguard the interest of the United States.[20]

Based on its consideration of the task force assessment, the CIEP executive committee came to three major conclusions. First, the liberal, non-discriminatory policy toward capital inflow-- conditional to certain internationally accepted exceptions-- should remain the goal of the United States. Second, the president should discourage any congressional effort to legislate new restrictions on inward investment because restrictions would conflict with the OECD Capital Movements Code, deny the United States many economic benefits of new sources of capital and knowledge, and have no significant gainful impact on the national security of the United States.[21] Third, the existing system of data collection should be improved so that the current amount and pattern of inward foreign investment can be more accurately tracked.[22]

---

[19]Pastor, *op. cit.*, p. 226

[20]Internal memorandum of the Council on International Economic Policy, October 19, 1973.

[21]*International Economic Report of the President* (Washington, D.C.: U.S. Government Printing Office, 1974), p. 65.

[22]*Ibid.*

In these conclusions, the CIEP executive committee concurred with the *laissez faire* assessment of its task force. If there was any internal disagreement about the policy implication of the assessment, it was about the proposal to improve the data collection system. Some members of the committee felt that gathering more detailed information on foreign investment was an unnecessarily dangerous step, something that amounted to a restrictive policy. However, the committee, as a whole, did appreciate the fact that government's data on foreign investment activities were inadequate and needed improvement.[23]

Predictably, the committee assiduously avoided any mention of a monitoring mechanism in its recommendation for updating the data collection system. It feared that establishing an apparatus for collecting data would eventually lead to a full-blown, legally mandated screening process in which many types of foreign investment might be restricted or banned outright. Just as the earlier government attempt to control the outflow of capital from the United States moved from voluntary measures to officially mandated controls, many members of the committee feared that the creation of any form of screening mechanism would, soon or later, lead to the imposition of restrictions and bans on foreign investment in the United States.[24]

The president was inclined to do nothing, but he accepted the CIEP executive committee recommendation to improve the data collection system as something prudent and, perhaps more importantly, as a way of containing congressional activism on the issue. Indeed, the White House was

---

[23]Personal interview with a former CIEP member.

[24]*Ibid.*

increasingly nervous about congressional grandstanding, and it decided to move fast to limit the "damage" of legislative enthusiasm. Though it was not clear whether the White House had the necessary legal means to make the decision without congressional authorization, the president, through CIEP, ordered various executive agencies to carry out the needed measures to collect the data required to better assess the magnitude and the pattern of incoming foreign investments.[25]

The president also made another decision: He decided to support the Inouye bill that called for a comprehensive study of foreign investment in the United States. His decision had two motives. First, he wanted to demonstrate to Congress and the public that his administration was just as concerned about the investment issue as they were; second, he wanted to give the moderates in Congress the upper hand in their struggle with the more restrictionist lawmakers. However, it is revealing that, even here, the White House chose to preempt Congress by ordering the Commerce Department to send out questionnaires for a new benchmark study on foreign direct investment before Congress mandated the study by law.[26]

It is interesting to note that the top officials at the Commerce Department had already considered a major new study on foreign investment activities in the United States. However, they quietly shelved the idea because they felt that they lacked the sufficient authority to carry it out.[27] Obviously, that problem was resolved by the White House decision to support a comprehensive study. The Treasury Department was also directed

---

[25]Niehuss, *op. cit.*, pp. 79-81.

[26]*Ibid.*

[27]Pastor, *op. cit.*, p. 227.

by the White House to launch a study of its own, and it sent out its own questionnaires on January 1, 1974 for a new benchmark study of foreign portfolio investment.[28] Both the Commerce and Treasury studies were successfully launched without obtaining any legislative authority.[29]

The measures taken by the president and the official report of the CIEP executive committee were formally presented to Congress in the testimony of Peter Flanigan to Senator Stevenson's Subcommittee on International Finance on January 23, 1974 and to Representative Culver's Subcommittee on Foreign Economic Policy on January 29, 1974. From Flanigan's testimony and those of others, committee members were surprised to discover that the U.S. government did not, in their minds, have a coherent policy toward incoming foreign investments. To their dismay, they discovered that what rules and regulations that existed could only be described as a "patchwork": They learned that inward foreign direct investment is overseen by a multitude of agencies at the federal, state, and local levels that were, in many cases, pursuing contradictory goals.[30]

These committee members discovered that existing policies ranged from one of outright discrimination and restriction to enticing inducement. They learned that, on the one hand, foreign investment is subject to deliberate, discriminatory exclusion from certain sectors and industries,

---

[28]The last benchmark survey of foreign direct investment had been undertaken in 1959 while a study on portfolio investment had been conducted in 1941.

[29]In order to conduct the study, the Commerce Department requested in June of 1974 additional funds from the Senate Appropriations Committee before the various congressional committees had even reported on the Inouye bill. U.S. Senate, State, Justice, Commerce, the Judiciary and Related Agencies Subcommittee on Appropriations on H.R. 15404 for Appropriations for FY 1975, May 29, June 4-6, 11, 12, 1974, p. 632. (Cited in Pastor, *op. cit.*, p. 228.)

[30]John Culver, "Foreign Investment in the U.S.," *Foreign Policy*, Vol. 16 (Fall 1974), p. 160.

while, on the other, the federal government and particularly local authorities devote good deal of time, money, and effort to attract foreign investments for the purposes of generating employment, capital inflow, increased competition, and the transfer of technological and managerial skills to their respective jurisdictions. They also found that, short of the president evoking the Trading with the Enemy Act, a drastic step, the U.S. government did not have any simple way of prohibiting undesirable foreign investments.

It was also evident from the exchange of views between the administration representatives and the committee members at some of these hearings that, while the fundamental security concerns about foreign direct investment were the same for the policymakers in the White House as well as Congress, the policy prescriptions that they drew from the facts of the issue were quite different.[31] Though the president and his aides understood as well as those in Congress did the dangers of unmonitored foreign direct investment in the United States, their priority was on protecting and, if possible, expanding the liberal trade and investment environment. Those in Congress, however, were interested in finding out more about the existing policy and discovering regulatory gaps that might need tightening.

In the course of these hearings, the policymakers in Congress necessarily relied on the executive branch for the data on foreign investment activities in the United States and to point out the inadequacies in existing policies. Obviously, this gave the White House an important leverage in its "management" of Congress. After all, without easily accessible alternative sources of information and research, Congress could not do much other than

---

[31]Hearings on Foreign Investment in the United States before the Subcommittee on International Finance of the Senate Committee on Banking, Housing, and Urban Affairs, 93rd Congress, 2nd sess., January 1974. See Pastor, *op. cit.*, p. 229.

introduce legislations and attempt to get a few of them passed.[32] It is clear from White House's careful management of the availability of relevant information in its attempts to dilute the policy activism of Congress that the president made good use of his executive advantages.

On the other hand, in dealing with the White House, those in Congress were not unfamiliar with the situation in which they found themselves. In terms of the substantive aspect of the policy question concerning foreign investment, many in Congress, particularly those with internationalist leanings, were reluctant to press the White House too hard for a more aggressive policy stance against the inflow of foreign capital. As with the president, they too were mindful of the potential protectionist backlash in other areas of foreign economic policy if radically restrictive measures were put in place to limit, or otherwise control, the inflow foreign direct investment.

Hence, for example, the moderates in Congress were reluctant to fight the president on the issue of where to lodge the responsibility for the studies called for by the Inouye bill. Although the White House had already ordered the studies from the Commerce and Treasury departments, they could have insisted that these studies be conducted by some independent, non-governmental or congressional organizations. However, they chose not to.[33]

---

[32]For instance, with the Inouye bill, the staffers in charge of the hearings spent most of their energy trying to get the bill passed. They did not have the time, easy access to data, nor technical resources to advance the bill toward a more ambitious end, for example, setting up a more permanent reporting or monitoring system. *Ibid.*, p. 233.

[33]Of course, the fact that the White House had already ordered the studies from the Treasury and Commerce departments and had even obtained funding from the appropriations committees constituted something of a *fait accompli.*

Interest Groups

In the policy give-and-take that took place among elected policymakers, it is interesting to note that the interest groups that are normally active in the foreign economic policy arena were rather passive and of no particular help to policy partisans in Congress or the White House. Indeed, most industry and labor groups did not even offer comments at the many congressional hearings until the contending policymakers prodded them to take their side on the policy debate.[34]

The groups representing the interests of large domestic businesses supported the maintenance of free investment environment as a matter of principle, but other than releasing some general pronouncement to that effect in response to White House prodding, they were not particularly concerned about the issue. When Congress began to consider restrictionist bills, they expressed their fears about retaliation against American business interests abroad, but they also knew that many countries already had extensive regulations targeting foreign direct investment in their markets which they felt could not get any worse.[35] Major industry groups, such as the United States Chamber of Commerce, the National Association of Manufacturers, and the National Foreign Trade Council, wrote letters to Congress and the White House with their views, but they did not go beyond "position taking."

Labor groups were also unconcerned about the issue of inward foreign direct investment. While it realized that some kinds of inward foreign direct investment can bring benefits to American workers, the AFL-CIO ultimately took a policy position against the increasing flow of foreign direct investment

[34]Pastor offers a similar observation of interest group passivity. Pastor, *loc. cit.*

[35]Personal interview with an industry lobbyist.

in the United States.[36] After all, having strenuously opposed the overseas investments by American companies for years on the ground that such investments exported domestic jobs, it felt that American labor had to denounce inward direct investment as a matter of principle.

Similar to industry groups, organized labor did not show much zeal for acting upon its stated positions to achieve some concrete policy outcome. Considering the vigor and passion of its campaign and the expenditure of political capital against U.S. direct investment activities abroad, its opposition to inward foreign investment in the United States was practically nonexistent. The AFL-CIO belatedly issued a statement decrying the ills of foreign takeover of domestic enterprises.[37] However, labor's purpose in publicly denouncing inward foreign direct investment was quite limited and driven by tactical political considerations: With the Republicans controlling the White House and unions' traditional weakness in the Sunbelt states, the most receptive region toward foreign direct investment, the labor interest simply wanted its allies in Congress to be involved in monitoring of the impact of foreign direct investment on the welfare of unionized workers.

Congressional Ferment: Part II

On October 6, 1974, President Gerald Ford, replacing disgraced Nixon, signed the Inouye bill into law as the Foreign Investment Study Act. The law

[36]In general, individual member unions supported foreign investments when they created new employment opportunities.

[37]During its convention in October of 1975, the AFL-CIO adopted a resolution that condemned "the unregulated takeover of U.S. firms by foreign interests" and announced that its "opposition to this new threat to the job security of U.S. workers will be expressed in the courts, before administrative agencies, by public information programs and through unstinting support of necessary corrective legislation." See Paul Lewis, "Economic Report/Welcome mat still out for foreign investors in the U.S.," *National Journal*, January 10, 1976, p. 32-3.

formally charged the Treasury and Commerce departments with making an in-depth study of foreign investment in the United States and asked for an interim report to go to Congress within a year and a final version-- "together with such recommendations as they consider appropriate"-- not later than by April 26, 1976.[38]

With the enactment of this law, the White House hoped that the activism in Congress toward inward foreign investment would die down. Unfortunately for the White House, the signing of the bill into law did not abate congressional activism. International events got in the way.

While the mandated executive branch studies were underway, the national anxiety about foreign direct investment took a quantum leap as soon as the economic implication of the first oil crisis became obvious to everyone. Some initial studies on the financial impact of OPEC price increases predicted that the oil exporters would amass a collective fortune of over a trillion dollars in the coming decade, with the bulk of it held by the Arab producers along the Persian Gulf.[39] For example, the World Bank study of 1974 estimated that OPEC members might accumulate 650 billion dollars in surplus cash by 1980 and as much as 1.2 trillion dollars by 1985.[40]

Fear gripped the nation that OPEC wealth might be used by the Arab states, who just used oil to take political action against the West, to threaten a dangerous leverage over the United States. Specifically with regard to direct

---

[38]PL 93-479; 88 Stat 1450.

[39]*National Journal*, August 31, 1974, p. 1310.

[40]In 1975, the World bank revised down its 1980 estimate to 460 billion dollars. Other studies showed figures somewhat less than those of the World Bank, though still high enough to be alarming at the time. See Paul Lewis, "OPEC's Takeover Threat," *National Journal*, January 10, 1976, p. 37.

investment, the fear was that the Arabs might attempt to advance their interests through strategic investments in key sectors of the U.S. economy. Given that the total value of all listed stocks on the New York Stock Exchange at the time was something less than 700 billion dollars, the Arab members of OPEC could have conceivably bought a tenth of interest in every listed U.S. company for a mere 70 billion dollars, a small fraction of the estimated total surplus dollars projected to accumulate in the hands of OPEC states.[41]

Alarmed by this great potential danger to the national security of the United States, several senators initiated a fresh round of legislative activism targeting inward foreign investments. The day after the House passed the Foreign Investment Study Act, Senator Howard Metzenbaum introduced a bill (S. 3955) in the Senate which would establish a foreign investment screening agency-- to be known as the Foreign Investment Review Administration-- within the Commerce Department to review and analyze foreign investment activities in the United States on a continuing basis.[42]

The proposed legislation also called for the executive branch to produce a series of studies and reports containing specified data required by law which would be made public periodically. Metzenbaum's bill had wide support in the Senate, and it was cosponsored by Senators Inouye, Stevens, Allen, Cranston, Huddleston, Humphrey, Metcalf, and Nunn.

White House Reaction: Part II

Not surprisingly, the White House opposed the Metzenbaum bill. President Ford objected to the new bill for the same reasons Nixon resisted

---

[41] *Ibid.*

[42] Pastor, *op. cit.*, p. 239.

any legislation tougher than the survey act just passed. As earlier under President Nixon, CIEP was directed to respond to congressional activism in a low-key manner: It was ordered by the president to organize a new policy review with the hope of pacifying Congress with a promise of yet another study.

The new review was conducted by two CIEP groups. One study group was formed with the Office of Management and Budget (OMB). Its mission was to survey all the government agencies that collected data on foreign investors and determine whether or not the existing reporting requirements were adequate.[43] Using the report and data submitted by the first group, another high-level policy study was conducted by the second CIEP group beginning in late 1974 and continuing into the spring of 1975.

While the earlier review initiated by President Nixon dealt with the more general questions about incoming foreign investment, the review process ordered by President Ford was more narrowly focused on the question of OPEC investment. Furthermore, the policy review by the Ford administration dealt with the specific question of whether or not the United States had the proper regulatory tools to adequately safeguard its national security and economic interests from potential political manipulation or interference by foreign investors.

Not surprisingly, the findings of the new review were similar to the conclusions of the one conducted a year earlier.[44] The review found that the existing safeguards against undue foreign influence were, on the whole,

---

[43] "Joint Report of the Council on International Economic Policy and the Office of Management and Budget," *United States Government Data Collection Activities with Respect to Foreign Investment in the United States* (Washington,D.C.: U.S. Government Printing Office,1975).

[44] Pastor, *loc. cit.*

sufficient and there was little need for a more restrictive regulatory regime. However, the CIEP/OMB component of the review did acknowledge that a legislation was required to identify the true beneficial owners of U.S. securities in order to more accurately document the real magnitude of inward foreign investment.[45] Predictably, the CIEP/OMB study cautioned that the law should be written so that it would be applied in a nondiscriminatory manner without regard to domestic or foreign investment.

While the policy review was being conducted by CIEP and OMB, there were more bills being proposed and considered in Congress. For example, Senator Harrison Williams' Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs was holding hearings to consider a bill (the Foreign Investment Act of 1975. S. 425) which the New Jersey Senator introduced in the Senate on January 27, 1975 with seven cosponsors to address the same issues CIEP was dealings with.[46]

The Williams bill was clearly the most important legislative proposal being considered; and it called for the disclosure of beneficial ownership of all equity securities of publicly held corporations, whether owned by foreigners or U.S. citizens. It would also require foreign investors to notify the Securities and Exchange Commission (SEC) and the president in advance of any purchase of five percent or more of the equity in any American corporation. Furthermore, it would authorize the president, at his discretion,

---

[45]CIEP also concluded that several minor administrative actions would be necessary to implement this decision.

[46]Pastor, *op. cit.*, p. 240.

to prohibit any such acquisition for the sake of national security, foreign policy objectives, or protection of American economic interests.[47]

Senator Williams also added an amendment to his bill that would prevent the acquisition of stocks in domestic companies by foreigners who compel or attempt to compel others to boycott U.S. businesses. The amendment would force the divestiture of stocks by foreigners who use their control of a domestic company to promote such a boycott.[48] There was much support for the amendment in Congress given the Arab boycott of U.S. firms doing business with Israel.

It was at the Williams hearings that Undersecretary of Treasury Jack E. Bennett presented the conclusions of the new executive branch review and the consequent administrative actions taken by the president. He reiterated White House's view that administrative monitoring of inward foreign investment was sufficient. He insisted that there was no need for measures mandating monitoring by the force of law, with the possible exception of some kind of a measure to require more thorough disclosure of beneficial stock ownership by foreign and domestic investors alike.[49]

Despite administration's best effort to soothe congressional nervousness about inward foreign direct investment, this time around, Congress was not easily persuaded by White House reassurances given the climate of near paranoia concerning the Arab threat to U.S. economic

---

[47]Hearings before the Subcommittee on Securities of the Committee on Banking Housing, and Urban Affairs, U.S. Senate, *Foreign Investment Act of 1975*, 94th Congress, 1st sess., on S. 425, March 1975, p. 1. (Williams Hearings).

[48]Richard S. Frank, "Arab Boycotts Undermine U.S. Premise," *National Journal*, March 29, 1975.

[49]Williams Hearings, p. 26.

interests. Policymakers in Congress continued to pressure the president for a more aggressive policy response to the increased volume of foreign direct investments. Realizing that its low profile approach was failing to satisfy Congress, the White House decided to take more publicly visible steps to placate the policy activists and reduce the urge to grandstand in Congress.

The Compromise

Unable to pacify Congress with reassuring charts and numbers, the White House had to give something more politically meaningful to the policy activists in Congress. Simply arguing that there was no policy problem could not satisfy those who had invested considerable political capital on the issue. The White House had to do something, even if only symbolic, to satisfy these congressional entrepreneurs and, ultimately, sooth voter anxiety.

Indeed, the White House had to pledge that it would create a high-level interagency committee reporting directly to the president to monitor incoming foreign direct investments and a new research office to serve that committee in its duties. In addition, the White House promised that, through this committee, the executive branch would negotiate procedures with foreign governmental investors for advance consultation with relevant federal agencies before they make any major direct investment in the United States.

The powers of the committee did not match those called for in Metzenbaum's proposed foreign investment screening agency, the Foreign Investment Review Administration. Nonetheless, its establishment had much symbolic importance. The creation of this new apparatus by the White House was something politically meaningful (if not in terms of substantive policy), something that was appreciated by Congress. After all, it meant reorganizing jealously guarded presidential handling of an aspect of U.S. foreign economic policy: Beyond merely compromising on a substantive policy matter, the establishment of CFIUS meant creating a new bureaucratic mechanism the president did not really want.

The pledge to establish a high level monitoring committee was clearly a retreat by the president to a perimeter beyond yet another executive branch sponsored policy study or fact finding survey. The political risk was considerable in this. Indeed, the establishment of the committee involved the creation of a potential institutional entry point for Congress in president's conduct of foreign economic policy. Of course, the White House had much say in how the committee would function. After all, if the creation of the committee was not entirely its idea, the blue print for how the committee would actually function clearly was.

Undersecretary Bennett outlined the plan for establishing the new monitoring system in his testimony before the Williams committee.[50] The members of the committee were receptive to the plan, and this positive response from the Senate committee convinced the president and his aides that this gesture by the administration would be enough to satisfy Congress. Soon after Bennett's testimony, the president approved the immediate implementation of the plan. In order to preempt any congressional input in the design of the monitoring mechanism, the administration acted with great dispatch in executing the plan. Once again, instead of waiting for authorization from Congress, the White House took action unilaterally: The

---

[50]*Ibid.*

president created the committee called for in the plan through an executive order.

In the spring of 1975, the White House established the Committee on Foreign Investment in the United States (CFIUS). The executive order issued by President Ford authorized the committee to perform the following duties: First, analyze trends in foreign investment coming into the country; second, negotiate advance consultations with foreign governments desiring to acquire assets in the United States; third, review investments that may have national security implications; and, fourth, study new legislations or regulations targeting such investments.[51]

As it was originally staffed, CFIUS was chaired by Undersecretary of Treasury Edwin Yeo who had replaced Bennett. Other members included the State Department's assistant secretary for economic affairs, the deputy secretary of Defense, the undersecretary of Commerce, the executive director of CIEP, and the assistant to the President for economic affairs.[52] Despite the high ranks of the staffers, however, the actual powers granted to CFIUS were limited. For example, CFIUS was not given the authority to reverse an investment already made. Such a decision had to be deferred to the president. Furthermore, CFIUS was not a line department; therefore, among other things, it could not execute policy measures on its own.

---

[51]The same executive order also created the Office of Foreign Investment in the United States. The White House place it in the Domestic and International Business Administration of the Department of Commerce and charged it to assist in the government-wide effort to devise an improved data collection system on inward investment and then report periodically on the extent and nature of foreign investments in the United States. Executive Order 11858, May 7, 1975.

[52]Pastor, *loc. cit.*

The limited authority of CFIUS did not please some in Congress.[53] However, the White House convinced Congress that the power of review and publicity would be sufficient to deter any foreign investment that might be harmful to the national interest of the United States. If it were not, the White House reassured the lawmakers, the president could always invoke the Trading with the Enemy Act to block or nullify the offending investment.

Though the new review mechanism did not posses sufficient or specific powers to perform duties that some in Congress felt was needed to safeguard U.S. national interests, the issue leaders in Congress accepted CFIUS as a reasonable compromise between the needs of the White House and the requirements of Congress. CFIUS was, in effect, an institutional solution that resolved, at least for the time being, the tension between White House's traditional internationalist inclination and the president's desire to keep as much control as possible over foreign economic policy decisions on the one hand and what many in Congress felt were prudent and necessary measures (especially in the eyes of the voters) that would empower the government with a straightforward, non-extraordinary means to prohibit undesirable inward foreign investments on the other.

Indeed, the White House correctly calculated that CFIUS would be taken by Congress as sufficiently accommodating to assuage much of its concerns and greatly limit congressional grandstanding.[54] It properly judged that creating CFIUS would halt the slide toward a congressionally mandated policy solution that, in all probability, would have been far more restrictionist

---

[53] *Ibid.*, p. 241.

[54] *Ibid.*

than the one offered by the White House, an outcome that even those in Congress did not want.

The Denouement

Some months after the executive order creating CFIUS was issued, the findings of the studies mandated by the Foreign Investment Study Act became available. Although the Commerce and Treasury departments had at one time claimed that the studies would require three years to complete, they released their findings within the eighteen months allotted by the law.[55] The Interim Reports became available October 1975 while the nine-volume Final Report was submitted to Congress in April 1976.

The massive examination of inward foreign direct investment was based on 7,200 reports covering some 10,200 firms in the United States.[56] It estimated that foreign direct investment in the United States at the end of 1974 was approximately 26.5 billion dollars, up about 5.1 billion dollars from the previous year.[57] The studies revealed that the greatest investors in U.S. domestic assets were the British, Canadians, and Dutch, as that had been the case for quite a long time. Investments coming in from Britain, Canada, and Holland each accounted for about 20 percent of the total sum, while Germany (West) accounted for 6 percent and Japan for only 1 percent.[58] The Commerce

---

[55] *Ibid.*, p. 242.

[56] The previous study of 1959 was based on only 450 reports.

[57] Commerce Report, April 1976, pp. 55-8. (Cited in Pastor, *op. cit.*, p. 243.)

[58] *Ibid.*, pp. 19 & 35ff.

report concluded that "there is no need to change the basic U.S. policy toward investment from abroad..."[59]

Combined with the creation of CFIUS, the findings of the Treasury and Commerce studies-- particularly the fact that the country was not being "taken over" by the Arabs and the Japanese-- effectively quieted congressional policy activism on the issue of foreign direct investment in the United States. Of course, some lawmakers continued to introduced, revise, and refine their restrictionist bills for some time. However, an effective compromise was struck among the principal policymakers in the White House and Congress. A kind of policy equilibrium had been reached.

Summary

Coinciding with sudden jolts of international economic crises, the globalization of markets for capital as well as goods and services, and the decline of U.S. economic competitiveness, the issue of inward foreign direct investment emerged as a major foreign economic policy issue in the United States during the mid 1970s. Reacting to the widespread public fear of the possible loss of national sovereignty caused by the sudden surge of incoming foreign investments, the policymakers in the White House and Congress had to examine in detail the long forgotten policy toward inward foreign direct investment during this tumultuous period.

Given the fact that what amounted to U.S. policy toward inward investment had been lying more or less dormant since the prewar years, the

[59] *Ibid.*, p. xiii.

first order of business for policymakers was to discover what rules and regulations existed already targeting incoming investments as well as determine the true magnitude of capital flowing into the United States. The policy product of this discovery process and the process itself show that one of the key factors that determined the scope and shape of this reassessment of U.S. policy toward inward foreign direct investment was the political interaction between elected policymakers in the White House and Congress.

The president and members of Congress, as those hold ultimate political power in the political system, were the principal movers in the policy revision process and were motivated to act by what they perceived--conditioned by their respective position in the institutions of government--as their own political interests as much as the national interest of the United States. While the White House, fearing a protectionist backlash against the free flow of international trade and investment and wanting to keep maximum presidential control over an important aspect of foreign economic policymaking, sought to limit congressionally mandated restrictions on inward foreign direct investment, the issue leaders in Congress pursued a policy agenda seeking a more discretionary and far reaching regulation of inward investments in order to focus a greater degree of executive branch attention to the investment issue as well as obtain favorable publicity for themselves.

In the resulting policy struggle between the president and those in Congress, the reactive foreign policy role which many analysts associate with Congress in thwarting the foreign policy goal of the executive was more applicable to the White House. While it is true that most measures proposed by Congress failed to get off the ground and its more radical bills fell to the wayside, it was not the case that the "executive elites of the state bureaucracy" prevailed over the "special interests gathered in the legislature." The more restrictionist proposals, such as Congressman Dent's, were never intended to succeed in the first place.[60] Their dual purpose was, first, a tactical one to hasten the policy review process by attracting the attention of the White House and, second, a political one to exploit the issue for possible electoral gains and garner recognition for the policymakers proposing them.

What tends to obscure the dynamics of structural choice in a policy arena where strong statist forces are expected to be operating is the fact that, in those instances where a new policy measure was necessary or unavoidable, the president went forward either unilaterally-- as when the Commerce Department was instructed to begin a new benchmark study in early 1974-- or executed it by a presidential order-- as when CFIUS was established. In both of these cases, and in others, policymakers in Congress had in fact introduced a bill suggesting a similar course of action, but the White House chose to implement the proposals by executive flat rather than legislation in order to maximize presidential influence and control.

Furthermore, the argument that foreign investment is generally beneficial to a host economy was accepted not only by the president but also by powerful members of Congress chairing "internationalist" subcommittees. In fact, there was never any serious consideration in Congress that foreign investment should be restricted across-the-board. The real substantive debate between the policymakers in the White House and Congress was about on what terms and how can the negative effects of inward foreign direct investment be minimized.[61]

---

[60] Pastor, *op. cit.*, p. 248.

[61] *Ibid.*

In all this, public opinion, though diffuse, mattered a great deal in motivating the *elected* policymakers in the initial stage.[62] Of course, it is true that policy issues were somewhat esoteric and very few people even knew what new bills were introduced or what new laws were passed in Congress, let alone what provisions they contained. However, the surge of incoming investments-- as it related to the general public apprehension about the economic security of the country, the motives of OPEC investors, and the Japanese trade surplus-- was something that many people were aware of and much worried about. Hence, the lawmakers in Congress who took up the issue as their own had good reasons to believe that they could expect some political benefit from their policy entrepreneurship while the president had to know that people's fears, no matter how irrational sometimes, was something that he could not ignore as the chief executive or as a politician.

Considering the impact public opinion had on the policymaking process, interestingly, organized interest groups did not much affect the direction or the momentum of the policy reexamination. Though labor and business groups had some auxiliary role in the policy debate between the White House and Congress, they did not play a prominent role in the policymaking process. To the extent that they held policy views and had any impact on the policymaking process, their success or failure in influencing policy was determined by the access provided by the policy principals: the elected policymakers in Congress and the White House.

The executive bureaucratic agencies also did not have much of an impact on the policymaking process. It is not clear that even the modest

[62]One indication of this concern with public opinion was the sheer number of citations of newspaper articles and editorials mentioned during congressional hearings and floor debates.

survey ordered by the White House would have been undertaken by the Commerce or Treasury departments on its own initiative without the firm direction from interested elected officials in the White House and Congress. With regard to the direct investment issue, there was no "elite group of executive branch institutions and officials" looking out for the best interest of the United States. Instead, the reactive role of the executive bureaucracy during the policymaking process illustrates how government agencies and bureaucrats are often manipulated to serve the goals of elected leaders who resolve collective choice problems in policymaking by creating procedures and hierarchies.[63]

The creation of CFIUS clearly illustrate this politics of structural choice. Establishment of CFIUS was a compromise solution between presidential goals and congressional concerns: While the president managed to keep a machinery of foreign economic policy under his leadership, CFIUS represented the institutional embodiment of the policy compromise assuring those policymakers in Congress that the inward investment issue would receive more political attention from the White House and remain subject to congressional scrutiny.

As it will become clear in the next three chapters, while quite powerless in its early days, CFIUS became greatly empowered during the late 1980s and the early 1990s through the renewed policy struggle among elected officials. As the inflow of foreign (particularly Japanese) direct investments increased enormously in the 1980s and the inward investment issue became redefined as a vital "economic security" matter and one of the most contentious issues

---

[63]Of course, this is not to deny that these "institutional solutions" in turn can also shape the substance of policy.

of the increasingly troubled U.S.-Japan bilateral relations, the policy compromise reached during the Ford administration had to be revised. The chapter coming up will discuss the circumstances leading to that revision.

CHAPTER NINE

Deluge of the Eighties

In the latter half of the 1980s, inward foreign direct investment once again became a major national concern with the economic power of Japan revealing itself so dramatically in the U.S.-Japan bilateral trade imbalance and the magnitude of Japanese direct investment in the United States. International structural changes-- the relative decline of American economic power, the concomitant rise of Japanese economic power, and the diminution of the Soviet military threat-- made the United States increasingly sensitive to relative gain considerations in global economic competition.

Indeed, this American sensitivity became especially acute *vis-a-vis* Japan which emerged in the 1980s as a superpower in manufacturing, finance, trade, and technology competing directly with the United States. This chapter details how this U.S. sensitivity fed the political controversy surrounding Japanese direct investment in the United States which in turn opened for renegotiation the policy compromise reached in the 1970s between the elected policymakers in Congress and the White House on the U.S. policy toward inward foreign direct investment.

The Economic Context

Even when the United States enjoyed a period of sustained economic growth in the 1980s, it could not hold at bay the vigorous foreign economic competition.[1] Its rate of productivity in manufacturing industries continued to lag behind those Japan and Germany.

Table 9.1

Growth rate of labor productivity in manufacturing, 1960-90

(percentage)

Period	U.S.	Japan	Europe*
1960-73	3.3	10.2	5.8
1973-79	1.2	5.0	4.1
1979-85	1.9	3.9	3.5
1985-90	3.1	4.3	2.8

*The figures for Germany (West) alone for 1960-70 is 5.7%, 1970-80 is 4.2%, and 1980-88 is 5.7% according to U.S. Department of Labor, *Handbook of Labor Statistics*.

Source: U.S. Bureau of Labor Statistics (cited in Kumihara Shigehara, "Causes of Declining Growth in Industrialized Countries," in *Policies for Long-Run Economic Growth*, Federal Reserve Bank of Kansas City, 1992).

In addition, because of the increasing globalization of markets as well as the relative decline of United States' economic prowess, America had become increasingly dependent on international trade and financial flows. Although by the end of 1980s the United States recovered its position as the leading exporting nation of the world, the country was living beyond its means-- accumulating record trade deficits while importing capital in huge sums to finance its public debts and private investments.

[1]The changes in real GNP for the Reagan "boom years" was 3.6 percent for 1983, remarkable 6.8 percent for 1984, 3.4 percent for 1985, 2.8 percent for 1986, 3.4 percent for 1987, and about 4 percent for 1988. See tables A2 and A3 in International Monetary Fund, *World Economic Outlook: Revised Projections of the Staff of the International Monetary Fund*, October 1988.

Table 9.2

U.S. merchandise imports, exports, and trade balance, 1960-91

(U.S. $ billions, current dollars)

Year	Exports	Imports	Balance
1960	$ 19.7	$ 14.8	$ 4.9
1965	26.4	21.5	4.9
1970	42.5	39.9	2.6
1975	107.1	98.2	8.9
1980	224.3	249.7	-25.4
1981	237.1	265.1	-28.0
1982	211.2	247.6	-36.4
1983	201.8	268.9	-67.1
1984	219.9	332.4	-112.5
1985	215.9	338.1	-122.2
1986	223.4	368.4	-145.0
1987	250.3	409.8	-159.5
1988	320.3	447.3	-127.0
1989	361.4	477.4	-116.0
1990	389.6	497.7	-108.1
1991	416.5	490.1	-73.6

Sources: *Economic Report of the President*, February 1992, and Joint Economic Committee, *Economic Indicators*, March 1992

Sometime in early 1985, the United States became a net debtor nation for the first time since 1914. The United States piled up huge external deficits, becoming the world's largest debtor from the position of being the largest creditor. The United States also became the world's top host nation in the total value of foreign-controlled activity, displacing the previous leader, Canada. The direct investment inflow to the United States, 15 percent of the total inflow to developed countries in the early 1970s, had reached almost 40 percent in 1981-85 and 46 percent in 1985-89.[2]

---

[2]Robert E. Lipsey, "Foreign Direct Investment in the U.S.: Changes over Three Decades," *NBER Working Papers*, 4124 (Cambridge, MA: National Bureau of Economic Research, Inc., July 1992), p. 5.

Table 9.3

Stock of inward direct investment in selected countries and regions, selected years, 1967-89

(billions of SDRs)

	1967	1973	1980	1989
All Countries	105.5	172.5	395.6	1,067.6
Developed Countries	73.2	127.4	308.5	862.4
United States	9.9	17.1	65.1	305.0
EC	24.8	56.4	146.5	368.2
Other Europe	6.6	9.9	19.9	42.6
Canada	19.2	27.4	40.4	78.4
Australia and NZ	4.9	8.7	22.0	52.7
South Africa	7.2	6.7	11.8	8.4
Japan	0.6	1.3	2.6	7.0
Developing Countries	32.3	45.1	87.1	205.2
Western Hemisphere	18.5	24.0	48.8	79.1
Africa	5.6	8.4	10.3	22.7
Asia	8.3	12.7	28.1	103.4
OPEC Countries	8.2	11.4	8.5	16.5

Source: U.S. Department of Commerce, International Trade Administration, Office of Trade and Investment Analysis, from national governments and international organizations.

Table 9.4

Distribution of inward direct investment in selected countries and regions, selected years, 1967-89

(percentage)

	1967	1973	1980	1989
All countries	100.0	100.0	100.0	100.0
Developed countries	69.4	73.9	78.0	80.8
United States	9.4	9.9	16.5	28.6
EC	23.5	32.7	37.0	34.5
Other Europe	6.3	5.7	5.0	4.0
Canada	18.2	15.9	10.2	7.3
Australia and NZ	4.6	5.0	5.6	4.9
South Africa	6.8	3.9	3.0	0.8
Japan	0.6	0.8	0.7	0.7
Developing countries	30.6	26.1	22.0	19.2
Western hemisphere	17.5	13.9	12.3	7.4
Africa	5.3	4.9	2.6	2.1
Asia	7.9	7.4	7.1	9.7
OPEC countries	7.8	6.6	2.1	1.5

Source: U.S. Department of Commerce, International Trade Administration, Office of Trade and Investment Analysis, from national governments and international organizations.

Indeed, during the 1980s, the combination of record trade and budget deficits, strong economic recovery, and the post-1985 fall of the dollar coincided with an unprecedented amount of foreign direct investment coming into the United States. In 1980, for example, Volkswagen's Pennsylvania plant was the only foreign-owned automobile assembly facility in the United States. Although the Volkswagen plant closed its doors, by 1990, six Japanese auto makers owned seven U.S. manufacturing plants, including their joint production facilities with American producers.[3]

Table 9.5

Flows of direct investment, 1970-90

(U.S. $ billions)

	Outward flow	Inward flow	Net outflow
1970	$ 7.59	$ 1.46	$ 6.13
1971	7.62	.37	7.25
1972	7.75	.95	6.80
1973	11.35	2.80	8.55
1974	9.05	4.76	4.29
1975	14.24	2.60	11.64
1976	11.95	4.35	7.60
1977	11.89	3.73	8.16
1978	16.06	7.90	8.16
1979	25.22	11.88	13.34
1980	19.22	16.92	2.30
1981	9.62	25.20	-15.8
1982	.97	13.79	-12.82
1983	6.70	11.95	-5.25
1984	11.59	25.36	-13.77
1985	13.16	19.02	-5.86
1986	18.68	34.09	-15.41
1987	31.05	46.89	-15.84
1988	16.22	58.44	-42.22
1989	31.72	72.24	-40.52
1990*	24.00	46.10	-22.10

*Outflow estimate based on Commerce Department figures reported in "Recent Trends in International Direct Investment: The Boom Years Fade," August, 1993.

Source: *Survey of Current Business*, various years.

---

[3]*Foreign Direct Investment in the United States* (Washington, D.C.: U.S. Department of Commerce, August 1991), p. 53.

Some have suggested that the coming together of trade and budget deficits, economic growth, and the decline of the dollar was the cause of the massive increases in foreign direct investment coming into the United States in this period. However, economists studying the dynamics of industrial organizations convincingly argue that the change in the United States' net foreign direct investment position was a part of the long-term international trend involving microeconomic factors already discussed in Chapter One.[4] Although foreign direct investment activities in the United States surged following the oil crises and coincided with the high interest rates in the United States in the early 1980s, the phenomenon of cross-border direct investment had been steadily growing around the world. This was especially true within the developed world.

What amplified the effect of this secular trend on the United States by the 1980s was the erosion of American economic superiority on all fronts: American leadership in productivity had shrank; its position as the innovating country in the product cycle had became uncertain; and the United States had become almost as much an importer as an exporter of high-technology goods. While the world stock of inward direct investment increased sharply during the last two decades-- from 208 billion dollars in 1973 to 505 billion in 1980 and to 1,403 billion in 1989-- the U.S. share rose proportionally faster-- 21 billion dollars in 1973, to 83 billion in 1980, and to 401 billion in 1989.[5] As a percent of the world stock, the U.S. portion grew from 9.9 percent in 1973 to 16.5 percent in 1980 and to 28.6 percent in 1989.

---

[4]The arguments of those who emphasize the micro versus macroeconomic variables can be found in Richard E. Caves, *Multinational Enterprise and Economic Analysis* (Cambridge: Cambridge University Press, 1982).

[5]*Foreign Direct Investment in the United States*, p. 21.

Le Défi Japonaise

On the political front, while world events were rapidly moving toward the termination of conflict between the East and the West, the realization was setting in among many Americans that the security problems of the future could take new forms and come from different directions, namely, an economic threat from a major trading partner. At the same time, the rise of Japan as a superpower, though an one-sided economic one, was having a sobering impact on the United States. By the early 1980s, Japan's economic reach expanded into a number of key high-technology industries and international finance, developments that fundamentally changed its bilateral relationship with the United States, the instigator of the postwar liberal economic order and the guarantor of Japan's security.

Because of its size and economic performance both at home and in the global marketplaces, by the early 1980s, Japan came to be seen by many as a serious challenger to the accustomed American leadership in international political and economic affairs. Despite the deepening integration of the U.S. and Japanese economies, Japan's rise as America's most important economic rival for markets and technological leadership became one of the key features of the international system.

Japanese Direct Investment

Sources of Controversy

More so than any other, the Japanese direct investment in the United States became particularly notable and controversial during the 1980s. Given the growing sense of rivalry just discussed and the fact that Japanese firms had become the most spectacular competitors to U.S.-based corporations abroad, there was great national anxiety when the Japanese began to purchase large U.S. manufacturers, for example, the Firestone Tire & Rubber Company. Adding to the apprehension in the United States was the fact that Japan had also become the world's principal exporter of portfolio capital during the 1980s and the main source of financing for the U.S. current account deficit. During the Reagan years, when the federal budget and trade deficits increased enormously, the Japanese purchased equally huge amounts of Treasury bills and securities of American companies, making Japan the largest net creditor and the United States the largest net debtor in the world by 1985.

However, by the late 1980s the composition of worldwide Japanese outward investment shifted largely away from portfolio to direct investments. The most significant part of this shift took the form of a rapid increase in the Japanese purchases of American companies, real estates, and other assets.[6] Although the amount of American assets owned by the Japanese still lagged that owned by the British who increased their investment over a longer period of time, Japanese investments attracted great public attention because they tended to be directed toward highly visible assets-- some of them, virtual national icons.

Some argue that Japanese investments became controversial because Japan was the first non-European nation to have a major investment

[6]Catherine L. Mann, "Determinants of Japanese Direct Investment in U.S. Manufacturing Industries," *International Finance Discussion Papers*, 362, (Washington, D.C.: Board of Governors of the Federal Reserve, September 1989).

presence in the United States.[7] Others suggest that the same amount of money spent by the Japanese on the Rockerfeller Center and the Pebble Beach golf course might not have caused as much public controversy had it been spent on less visible properties. Whatever the contributing factors, the essential fact remains that the velocity and volume of Japanese direct investments coming into the United States during the 1980s produced much anxiety in the United States.

Table 9.6

Foreign direct investment in the United States by country of origin, December 31, 1991

(U.S. $ billions)

Source	Value of assets
United Kingdom	$106.1
Japan	86.7
Netherlands	63.8
Canada	30.0
Germany	28.2
France	22.7

Sources: U.S. Department of Commerce, 1992.

To be sure, the British were also busy during the 1980s making extensive direct investments in the United States. However, they never attracted the notoriety of the Japanese. For instance, no major public or private studies of foreign direct investment in the United States commissioned during this period felt the need to include a section on the impact of British investment in the United States, whereas a special section

[7]Charges of racism aside, there is a feeling among many that Japanese firms behave differently from other foreign firms, either because of their protected domestic base or because they have a different culture and institutional structure.

devoted to Japanese investment was almost obligatory.[8] Whatever the reasons for this, clearly, the velocity of Japanese money coming into the United States was one of the more important reasons.

Table 9.7

Direct investment position in the United States by country of ultimate beneficial owner, 1980-90

(U.S. $ billions)

Year	U.K.	Holland	Canada	Japan
1980	$14.0	$19.1	$12.2	$4.7
1981	18.6	26.8	12.1	7.7
1982	28.4	26.2	11.7	9.7
1983	32.2	29.2	11.4	11.3
1984	38.4	33.7	15.3	16.0
1985	43.6	37.1	17.1	19.3
1986	55.9	40.7	20.3	26.8
1987	75.5	46.6	24.7	34.4
1988	95.7	48.1	26.6	51.1
1989	105.5	56.3	28.7	67.3
1990	108.1	64.3	27.7	83.5

Source:*Survey of Current Business*, various issues.

Table 9.8

Change in direct investment position in the United States,
by country of ultimate beneficial owner, 1980-90

(U.S. $ billions)

Year	U.K.	Holland	Canada	Japan
1980	$4.2	$6.5	$5.0	$1.2
1981	4.6	7.7	0.0	3.0
1982	9.9	-0.6	-0.4	2.0
1983	3.7	3.0	-0.3	1.7
1984	6.2	4.5	3.9	4.7
1985	5.2	3.3	1.8	3.3
1986	12.4	3.7	3.2	7.5
1987	19.6	5.9	4.4	7.6
1988	20.2	1.5	1.9	16.7
1989	9.8	8.2	2.1	16.2
1990	2.5	8.0	-1.0	16.2

Source: *Survey of Current Business*, various years.

[8]For example, see the section entitled "The Role of Japan" in Graham and Krugman's *Foreign Direct Investment in the United States*. See also special "Japan sections" in U.S. government documentssuch as "Recent Trends in International Direct Investments: The Boom Years Fade," published by the U.S. Department of Commerce in August 1993.

Table 9.9

Percentage growth of direct investment in the United States
by country of ultimate beneficial owner, 1980-90

(percentage change)

Year	U.K.	Holland	Canada	Japan
1980	--	--	--	--
1981	32.6	40.1	-0.4	63.0
1982	53.1	-2.4	-3.4	25.7
1983	13.0	11.3	-2.3	17.1
1984	19.4	15.7	33.7	41.5
1985	13.5	9.9	12.1	20.4
1986	28.4	9.9	18.6	38.9
1987	35.0	14.5	21.5	28.3
1988	26.7	3.2	7.6	48.5
1989	10.3	17.0	8.0	31.7
1990	2.4	14.2	-3.3	24.0

Source: *Survey of Current Business*, various years.

Table 9.10

Distribution of direct investment in the United States
by country of ultimate beneficial owner, 1980-90

(percentage of total stock)

Year	U.K.	Holland	Canada	Japan
1980	16.6	25.0	14.4	6.2
1981	17.2	24.9	11.0	7.1
1982	23.0	21.0	9.3	7.8
1983	24.0	21.3	8.2	8.2
1984	23.3	20.5	9.3	9.7
1985	23.9	19.7	9.1	10.4
1986	25.4	18.5	9.2	12.2
1987	28.7	17.7	10.1	13.1
1988	30.4	15.3	8.4	16.2
1989	28.2	15.1	7.7	18.0
1990	26.8	15.9	6.9	20.7

Source: *Survey of Current Business*, various years.

Patterns of Japanese Investment Abroad

While Japanese purchases abroad surged dramatically in the 1980s, the history of Japanese outward investment goes back a bit further and can be divided into two phases: the first, the mid 1960s to the late 1970s; the second, the early 1980s to the early 1990s. In the first phase, Japan was primarily an exporter of finished goods, and direct investment abroad simply played an ancillary role in the Japanese economic expansion. In the second, direct investment assumed a much more significant role-- and captured the headlines-- as the Japanese economy shifted from trade to investment orientation.[9]

By the mid 1960s, Japan began to accumulate current account surpluses, and the Japanese government relaxed its many controls on outgoing capital investments, which led to a noticeable increase in the aggregate outward direct investment.[10] The outflow of Japanese capital was directed mainly to three kinds of activities: the development of natural resources, manufacturing in low technology industries of developing countries, and investments in service industries supporting trading activities in developed countries. In this period, Japanese investment activities in developing countries were far greater than those in developed countries.[11] Also, it is interesting to note that most of the Japanese firms engaged in direct investment activities were not necessarily Japan's largest firms.[12]

However, as Japan began accumulating trade surpluses with the United States, the Japanese government decided to encourage Japanese corporations

---

[9]For an account of the changing nature of Japanese direct investment abroad, see Young-Kwan Yoon, "The Political Economy of Transition: Japanese Foreign Direct Investment in the 1980s," *World Politics*, Vol. 43, No. 1 (October 1990), pp. 1-27.

[10]*Ibid.*, p. 4.

[11]*Ibid.*, pp. 4 & 5.

[12]*Ibid.*, p. 6.

to establish production and service facilities in the United States.[13] Although much of the initial Japanese investments ended up in real estate assets in Hawaii and California, some also went to manufacturing facilities.[14] While the aggregate amount of Japanese investment was insignificant compared to the total stock of foreign-owned assets in the United States, the Japanese showed a predilection for buying highly visible, "prestige" assets, such as well-known hotels in tourist areas.[15]

The pattern of Japanese direct investment abroad converged toward the OECD norm during the 1980s.[16] Japanese investments shifted away from opportunities in developing countries with natural resources and low-wage labor to those in developed countries with a market and technology focus. This change was in part driven by the increasing importance of large oligopolistic firms in direct investment activities and represented a fundamental shift from a trade-oriented to a rentier economy, a pattern followed by Great Britain in the late nineteenth-century and by the United States in the postwar period.[17]

---

[13] *National Journal*, November 24, 1973, pp. 1753-4.

[14] The investments in manufacturing facilities were especially designed to gain access to raw materials or cheaper production costs. Typical investments included the integrated aluminium maker Alumax, a joint venture between Nippon Steel and AMAX Inc. established in 1974.

[15] Hence, even from the beginning, Japanese investments had the tendency to attracted public attention.

[16] Yoon, *op. cit.*, p. 2.

[17] *Ibid.*, p. 9.

The Japanese government actively encouraged this transformation.[18] Since 1983, Japan's Ministry of International Trade and Industry (MITI) promoted foreign direct investment as a part of the strategy of "industrial collaboration"-- a concept which also included technology transfers and joint ventures-- in order to diffuse trade conflicts with Japan's major economic partners.[19] Consequently, when the U.S. budget and trade deficits grew enormously large and difficult to reduce during the 1980s, the Japanese corporate investment in the forms of purchases of U.S. Treasury bills and American companies and real estates rose at an accelerating rate at the urging of the Japanese government.

Indeed, there was more to the pattern of Japanese outward investment than those macroeconomic and microeconomic factors considered above. More than those from other countries, direct investments from Japan also had their origin in politics. They were, in part, the result of trade protectionism and threat thereof. Especially in capital and labor-intensive industries, the Japanese faced increasingly severe protectionist measures from other industrialized nations. To bypass these obstacles, Japanese companies had to produce directly in markets abroad.

This political motive was one of the most compelling drivers of Japanese direct investments in electronics, automotive, and steel industries

---

[18]On this Japanese government support of outward direct investment, see Terutomo Ozawa, *Multinationalism, Japanese Style: The Political Economy of Outward Dependency* (Princeton: Princeton University Press, 1979), pp. 33-9.

[19]In another example of active government support, the Ministry of Finance backed a loan program of the Export-Import Bank of Japan for Japanese investment ventures abroad as well as providing various tax incentives favorable to outward foreign direct investment. Yoon, *op. cit.*, p. 9.

in the United States during the 1970s and 1980s.[20] For example, after the United States imposed import ceilings on various consumer electronics goods, automobiles, and steel products, virtually all major Japanese producers established or acquired assembly plants and manufacturing facilities in the United States. Interestingly, some protectionist U.S. trade measures went a long way to help the Japanese in making these direct investments. Intended to give American producers some breathing room, the voluntary restraints negotiated during the early 1980s to limit Japanese sales in the U.S. market proved to be a financial boon for the major Japanese producers. By reducing competition among suppliers, the voluntary restraints raised total profits on the restricted volume of Japanese imports and thus helped indirectly to finance the construction of Japanese-controlled production facilities in the United States.

In addition to the protectionist policies at the national level spurring the Japanese to invest in the United States, many state and local governments enacted policies favorable to foreign investors. Local governments openly competed with each other in the 1980s by offering foreign investors attractive investment incentives. By the mid 1980s, many local governments opened representative offices in Tokyo and other Japanese cities attempting to attract investors to their localities. They offered tax breaks, provision of free infrastructure or land, and direct subsidies to entice the Japanese to invest in their regions.

Nonetheless, regardless of various political constraints and incentives, the fact remains that Japanese firms, as with others firms of the OECD, were

---

[20]See Dominick Salvatore, "Trade Protection and Foreign Direct Investment in the U.S.," in *The Annals of the American Academy of Political and Social Science*, Vol. 516, July 1991, p. 91.

not simply responding to political considerations in their investment decisions. By investing in the United States, they were pursuing a long-term strategy of creating an infrastructure in the largest and most competitive market in the world that would allow them to sustain global competitiveness.

The massive increase of Japanese direct investments in the United States during the 1980s must be understood in the context of the reality that Japan had reached a turning-point in the internationalization of manufacturing, where overseas production increasingly replaced direct export from Japan-- not only in the host market, but in third markets as well. It has to be understood in the context of the strategy among oligopolistic producers around the world to increase market shares and achieve economies of scale. Not surprisingly, by the late 1980s, increasing number of Japanese-owned businesses in the United States were engaged in exporting from the United States to serve the Japanese domestic market.

Politics of Economic Competitiveness

The question still remains, given that the Japanese direct investment in the United States during the 1980s was a part of worldwide phenomenon of increased investment activities by the transnational corporations headquartered in the countries of the OECD, why Japan's investments received such a negative reception that they did in the United States? Here, the answer clearly lies in politics: the politics of economic competitiveness.

Since the mid 1970s, the fear of job losses due to foreign economic competition has driven the trend toward increased trade protectionism in the

United States. While the United States still talks a pretty good game of free trade, like the rest of the world it actually pursues politically managed trade, and many politicians during the 1980s seized upon the issues of trade and competitiveness as exploitable electoral tools. This emergence of international economic disputes as an "economic security" concern had a telling effect on the dynamics of U.S. inward foreign direct investment policy.

Japan as a Threat

By the late 1980s, the combination of American frustration over the persistence of trade imbalance with Japan and uneasiness about Japan as a newly emerged economic superpower spawned a new image of Japan: Japan as a threat. Nationwide polls indicated that many Americans no longer viewed the United States as the undisputed world economic leader and saw Japan as a stronger economic power than the United States.[21] Indeed, by that time, many in the United States began to consider Japan as a formidable challenger to American power and influence around the world and a threat to America's economic future.

Without question, the rise of Japan's economic power relative to the United States had been dramatic. In 1950, the size of the Japanese economy was about a twentieth of the U.S. economy. Forty years later, at nominal exchange rates, the Japanese economy achieved a per capita income level higher than that of the United States with the absolute size of the economy

[21]For example, a January 1990 Wall Street Journal/NBC nationwide poll found that while Americans were satisfied with the course of the U.S. economy, only 15 percent saw America as the world economic leader, and by a margin of better than three-to-one, they saw Japan as stronger than the United States.

reaching about 60 percent of that of the United States. Some predict that the Japanese economy would surpass that of the United States early in the twenty-first century. It remains to be seen whether the prediction will come true; however, the record of Japan's postwar economic achievements speaks for itself. The fact remains that Japan, by the end of the 1980s, had tripled its share of world product in thirty years, and it had become America's largest creditor and the United States was suffering from a continuous, enormous trade deficit with Japan.

Of course, Japanese commercial gains in the United States were nothing new. Japanese automobile exports, for example, began to appear in significant number in the early 1970s, about the same time Japanese consumer electronics goods were also becoming more and more visible in retail shops. In the 1970s, these Japanese gains did not cause much national concern. Japan in the 1970s was one of the countries with a recognized comparative advantage in international competition: cheap labor.

Table 9.11

U.S. trade with Japan, 1980-90

(U.S. $ billions, current dollars)

Year	Exports	Imports	Balance
1980	$ 20.8	$ 30.7	$ -9.9
1981	21.8	37.6	-15.8
1982	21.0	37.7	-16.8
1983	21.9	41.2	-19.3
1984	23.6	57.1	-33.6
1985	22.6	68.7	-46.1
1986	26.9	81.9	-55.0
1987	28.2	84.6	-56.3
1988	37.7	89.5	-51.8
1989	44.6	93.6	-49.0
1990	48.6	89.7	-41.1

Source: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis.

To those persuaded by the logic of Ricardian or Heckscher-Ohlin theory of cost advantage in production, it was no more disturbing to see a part of the consumer-electronics industry leave the United States for Japan than it was to see the steady shutdown of American textile mills to the benefit of those in the Third World. The Japanese gains were seen by many as natural changes in the global economy where America's comparative advantage lay in the development of its specialization in capital and technology intensive goods and services. Some Americans accepted the fate that the United States would shed industries as it "advances" and leave them to other countries down the product life cycle with cheaper labor and newer production facilities.[22]

However, this self-assured attitude about American competitiveness virtually disappeared by the late 1970s. By then, the Japanese penetration into the American consumer-electronic industry had turned into a rout and was threatening to turn into one in the high-employment automobile and steel industries as well as a number of others. More alarmingly, by 1978, the first Japanese semiconductors began to be sold in significant quantities in the United States, a turn of event which signaled that Japan ceased to be an "improver" of American products and technologies and was now a challenger of the United States as the technological leader and innovator in a broad range of vital industries.

The Specter of Japanese Technological Domination

Between 1980 and 1986, the U.S. trade balance in high-technology goods had gone from a surplus of 27 billion dollars to a deficit of 2 billion dollars. A

---

[22]See Raymond Vernon, "International Investment and International Trade in the Product Cycle," in Robert E. Baldwin and J. David Richardson, *International Trade and Finance: Readings*, 2nd. ed. (Boston: Little, Brown, 1981), pp, 27-40

major factor in that decline was the severe erosion of the U.S. semiconductor industry due to competition from Japan. Between 1978 and early 1987, the Japanese share of the global semiconductor market had expanded from 28 percent to about half of the market while the U.S. share had dropped from 55 percent to less than 40 percent.[23]

Of course, even late as the late 1970s, many Americans felt sanguine about U.S. leadership in the "industries of the future." In fact, in the semiconductor industry, American firms still controlled the U.S. market as well as a half of Europe's. This American domination applied to all categories of integrated circuits, including random-access memories (RAMs, the simplest mass-produced consumer products), erasable programmable memories (EPROMs), and many kinds of logic circuits and more complex microprocessors.[24] However, the demand for semiconductors was so great that the U.S. manufacturers could hardly meet their orders.

This gave the Japanese, who have carefully targeted the semiconductor industry as one of the industries of future, the chance to enter this strategically important market and introduce their products. The Japanese entered the market *en masse* as the demand for chips was soaring and the semiconductor industry was shifting from its earlier entrepreneurial mode to one that required larger scale and more capital.[25] The environment was ideal

---

[23]Charles H. Ferguson, "The Competitive Decline of the U.S. Semiconductor Industry," testimony before U.S. Senate Subcommittee on Technology and the Law, February 26, 1987.

[24]Michael Borrus, James Millstein, and John Zysman, "U.S.-Japanese Competition in the Semiconductor Industry: A Study in International Trade and Technological Development," *Policy Papers in International Affairs*, 17 (Berkeley: University of California, Institute of International Studies, 1982) p. 216.

[25]The cost of developing new chips spiraled up as technical advancement became more and more difficult while the cost of the average plant exceeded over 100 million dollars by the early 1980s. See Ferguson, *op. cit.*

for the Japanese giants who could take advantage of their stronger capitalization to build advanced production facilities and finance research and development.

The success of the massive Japanese spending on research and production facilities was readily evident.[26] By the end of 1979, the Japanese firms managed to controlled 42 percent of the sales of 16K RAMs, the most important segment of the memory market at the time.[27] And by 1980, the Japanese were acknowledged to be producing highly sophisticated electronic components more efficiently than their American competitors.[28]

The U.S. manufacturers hoped that their 64K RAMs would hold the line against the Japanese. They rushed to bring the chips to market and make them the basic building blocks of the lucrative computer and telecommunications industries. However, the Japanese firms jumped into this market in 1981 with great zeal, and by 1984 they had grabbed 60 percent of what was then a 2.7 billion dollar market. A few months later the Japanese were able to market the new generation of 256K memories, close on heels of

---

[26]In fact, between 1975 and 1982, the U.S. share of patents worldwide for semiconductor technology had dropped to 27 percent from 43 percent. Japan's share more than doubled, going from 18 percent to 48 percent. By the mid 1980s, more than 40 percent of the research papers presented at international conferences on integrated circuits came from Japan. Naturally, the Japanese began producing higher-quality chips and making significant advances in technology. *Ibid.*

[27]Borrus, Millstein, and Zysman, *loc. cit.*

[28]In March 1980, Richard Anderson, a Hewlett-Packard manger, made public the results of a comparative study of American and Japanese 16K RAM chips which showed that the best American products had a failure rate six times that of the poorest-quality Japanese products. Cited in Tom Forester, *High-Tech Society* (Cambridge: MIT Press, 1987).

U.S. firms; and, with their very aggressive pricing strategy, the Japanese soon claimed over 92 percent of the market.[29]

Table 9.12

U.S. trade with Japan in semiconductors and other related components, selected years, 1980-91

(U.S. $ billions, current dollars)

Year	Exports	Imports	Balance
1980	$ 0.3	$ 0.9	$ -0.6
1986	0.7	4.1	-3.4
1989	1.7	6.5	-4.8
1991	2.2	6.6	-4.4

Source: Selected figures from Table 2.7 in Laura D'Andrea Tyson, *Who's Bashing Whom?* (Washington, D.C.: Institute for International Economics, 1992), p. 27.

By the end of 1984, the top three Japanese semiconductor firms were among the world's five leading semiconductor manufacturers.[30] Out of fifteen U.S. firms in the memory market in 1976, only five remained in business.

Table 9.13

U.S. trade with Japan in all electronic products, selected years, 1980-91

(U.S. $ billions, current dollars)

Year	Exports	Imports	Balance
1980	$ 1.6	$ 5.5	$ -3.9
1986	3.5	23.9	-20.4
1989	7.5	27.7	-20.2
1991	8.2	27.9	-19.7

Source: Selected figures from Table 2.7 in Laura D'Andrea Tyson, *Who's Bashing Whom?* (Washington, D.C.: Institute for International Economics, 1992), p. 27.

---

[29]Defense Science Board Task Force, *Semiconductor Dependency* (Washington, D.C.: U.S. Department of Defense, February 1987), p. 20.

[30]The firms were NEC, Hitachi, and Toshiba.

In fact, by the mid 1980s, the Japanese penetration into the memory market was threatening to become another Japanese victory. In 1986, the Japanese firm of Fujitsu announced the marketing of the first megabyte DRAMs.[31] Furthermore, Japanese semiconductor manufacturers began exporting huge numbers of EPROMs to the United States by 1984, drastically bringing down the price of EPROMs on the U.S. market and causing huge losses for American semiconductor firms; and, by the late 1980s, the Japanese companies had begun to challenge the U.S. makers of more complex products, such as microprocessors and other products more upstream.[32] Many observers argue that only the political intervention to limit the floor prices and quantities of Japanese semiconductors marketed in the United States saved the U.S. producers' market share and, quite possibly, the domestic industry itself.[33]

Reaction to the Japanese Challenge

Given what was happening to so many American industries facing competition from Japan, there was a strong political reaction in the 1980s to

---

[31]IBM was the first to build the "megachips," but it did not market them; it used them only to fill internal needs.

[32]Of course, the presence of IBM (then, still mighty), which for many years had been able to set the rhythm of technical change and the standards for the entire computer industry, strongly countered the Japanese industrial march up the technology "food-chain," at least for a while. Nonetheless, though hampered by weaknesses in software development, the Japanese succeeded in marketing a full range of computers. In 1984, Hitachi announced its first supercomputer. Its arrival in a market previously monopolized by Control Data and Cray was followed closely by the arrival of similar models from NEC and Fujitsu. "High Noon for Fujitsu: Japan's Top Computer Maker Tries to Fight Off IBM and Keep Growing," *Electronics*, May 26, 1986.

[33]Borrus, Millstein, and Zysman, *op. cit.*, p. 50.

what was perceived, with paranoia in some circles, as "the Japanese challenge." Indeed, by the mid 1980s, many prominent politicians came to the conclusion that Japan was a "mercantilistic" state that shirks its own responsibility, let alone exercise the leadership role that its economic dynamism permits, but relays on the Untied States for defense of its strategic interests and maintaining an open global economy which is vital to its own economy.

Of course, as soon as Japan began its miraculous economic recovery after the devastation it suffered in World War II, the United States started to place pressure on Japan to lower its tariffs and remove other trade barriers. Nonetheless, the pressure was tempered by the strategic dictates of the U.S. anti-communist strategy in the Far East. By the late 1970s, however, the character of that pressure began to change when many in the United States stopped viewing Japan through a Soviet lens and America began losing entire industries to Japan in what increasingly appeared to be "unfair" competition.

Much of the perception that Japan competes unfairly with the United States had to do with certain asymmetry beyond numbers in trade between the United States and Japan. As matter of fact, the Japanese trade pattern has been rather unusual. For instance, at times, Germany's trade surplus had been greater than Japan's, but German business practices and government policies have attracted far fewer criticisms from abroad. Problem with Japan is that its level of intra-industry specialization has been remarkably low, hence imports of foreign manufactured goods have been kept lower than what is expected of an OECD economy.[34]

---

[34]Of course, it is difficult to determine why this is the case, and comparing Japan to Germany, which is at the center of a customs union, is unfair; nonetheless, there is little doubt that Japan remains relatively closed to foreign manufactured goods.

Table 9.14

Intra-industry trade levels, selected countries, 1980

Country	Intra-industry trade index no.*	Country	Intra-industry trade index no.*
France	82	Switzerland	61
Belgium	79	United States	60
Netherlands	78	Norway	51
U.K.	78	Finland	49
Canada	68	South Korea	48
Sweden	68	Japan	25
Germany	66	Australia	22
Italy	61		

*Based on 94 industries. The index is scaled to vary between 0 (no intra-industry trade) and 100 (complete intra-industry trade).

Source: Robert Z. Lawrence, "Imports in Japan: Closed Markets or Minds?" *Brookings Papers on Economic Activity*, 2 (Washington, D.C.: The Brookings Institution, 1987), p. 520.

When the Japanese trade surplus with the United States reached record highs in the 1980s, policymakers in the United States, at first, turned to macroeconomic solutions. They asked the Japanese to increase public spending to slow the export drive, but Japan was less cooperative than in the past and countered that it was the United States that needed to act by curbing its deficit spending.[35] When the Americans turned to monetary measures (which have been tried before with some success), the Japanese were more receptive and cooperative, agreeing to bringing down the overvalued dollar as part of the Plaza Agreement in September 1985.[36] However, the sharp rise of yen had only a limited impact on the bilateral trade balance while,

[35]Japan was more cooperative in this regard at the Bonn economic summit in 1978, accepting the "locomotive theory" that the surplus countries should act to stimulate world growth.

[36]First there was the 1971 revaluation of the yen insisted by the United States as part of the Smithsonian Agreement and then there was the 1977 attempt by the United States to prevent Japan from intervening under the flexible exchange system to avoid yen appreciation. See Yoichi Funabashi, *Managing the Dollar: From the Plaza to the Louvre* (Washington, D.C.: Institute for International Economics, 1988). Also, I.M. Destler and C. Randall Henning, *Dollar Politics: Exchange Rate Policymaking in the United States* (Washington, D.C.: Institute for International Economics, 1989).

revealingly, the U.S. trade deficit with the economies of the European Community improved strongly, turning into a surplus of 1.2 billion dollars in 1989.[37]

This chronic trade deficit with Japan touched off an intense debate about the appropriate policy toward Japan in the United States, and it gave birth to a new kind of politics that combined old-fashioned protectionism with concerns about "economic security." With the waning of the Cold War and the increasing prominence of international economic issues on the domestic political agenda, sectoral interests seeking protection became bolder and politicians more eager to cater to these demands, especially those from the high-technology sector.

Consequently, during the 1980s, issues of international economics gained new prominence in domestic electoral politics not seen since the prewar days. Congress entertained a great number of punitive legislative proposals against Japan's competitive practices, and electoral candidates of both parties (but particularly the Democratic party in the 1984, 1986, and 1988 elections) tried to exploit, with mixed results, the trade grievances against Japan.[38] Of course, in 1992, Bill Clinton won his presidency by promising, among other things, the restoration of national competitiveness *vis-a-vis* foreign economic rivals, namely Japan.

Furthermore, among the policymakers in Washington, a revisionist view of Japan began to take hold, a view that characterized Japan as a different

---

[37]Figure from the U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis.

[38]In the words of Tony Coelho, the chair of the Democratic Congressional Campaign Committee, trade was "a Democratic macho issue." *Congressional Quarterly Almanac*, 1985, p. 253.

kind of political economy that does not play by free market rules followed in other advanced industrial democracies. More and more politicians became convinced that Japan does not "play fair" and practices what Peter Drucker calls "adversarial trade" meant to target and destroy competing industries in other countries. Combined with the widespread popular resentment of Japanese economic successes, the increasing respectability of the revisionist view of Japan among political leaders virtually ensured a more confrontational policy approach toward Japan by the late 1980s.

Although the Republican-controlled White House of the 1980s generally resisted congressional and sectoral demands for a more results-oriented trade policy based on reciprocity, it had to take a more aggressive policy posture toward Japan given the new political climate. Indeed, in 1988, the Democrats in Congress, as part of their campaign to burnish the Democratic Party's image as the party championing economic competitiveness, passed the Omnibus Trade and Competitiveness Act with a new provision of Section 301 of the Trade Act of 1974 (as amended). The so-called "Super-301" charged the president to identify barriers to specific American exports that are unreasonable and to single out and name priority foreign countries for the number and pervasiveness of their acts, policies, or practices that hinders U.S. exports.

Since the provision was written with Japan in mind, the White House had little choice but to cite Japan under Super 301 for unfair trade practices regarding supercomputers, satellites, and wood products. In order to regain presidential control over the trade policy and deflect criticisms that the president was not doing enough to safeguard U.S. competitiveness, the White House also launched the Structural Impediments Initiatives (SII), a trade policy process which departed from the past practice by negotiating market-opening measures with the Japanese on a sector-by-sector basis, something that involved the most intrusive and sweeping effort by one country to change the economic and business practices of another. As a result, trade in some industries-- notably the semiconductors and auto parts-- has become no longer free but "managed" with the use of quantitative indicators. That is, in additions to the voluntary export restraints accepted earlier by Japan, policymakers in the United States pushed the reluctant Japanese to accept certain specific quantities of American goods.

Summary

This chapter discussed some important factors feeding the emergent politics of economic competitiveness. Indeed, by the 1980s, the similar composition of industrial outputs in the two economies and the fact that American and Japanese firms compete frontally across a wide range of industries practically ensured long-term conflict between the United States and Japan. And the continuing inaccessibility of the Japanese market-- the world's second largest and most advanced in many areas of technology-- fueled the politics of economic competitiveness which sought a political remedy to the "foreign assault" on domestic industries that employed large number of voters and conveyed important externalities and spin-offs to the rest of the economy.

The next two chapters will discuss how policymakers in Congress, with the complicity of the White House, linked the issue of foreign direct investment in the United States to the question of "fair trade" and economic competitiveness. They will address how these policymakers began to pursue a more flexible, discretionary regulation of inward foreign direct investment for the supposed reason of protecting American technologies and the domestic industrial base.

CHAPTER TEN

Politics of Economic Competitiveness

This chapter begins the discussion on the resurgence of federal government's regulation of inward foreign direct investment in the late 1980s as one of the key features of the emergent politics of economic competitiveness. This and the following chapter will show that, building on the regulatory mechanism established during the 1970s (already discussed in Chapter Eight), elected policymakers in the United States put into place in the late 1980s a screening mechanism that has the potential to systematically review virtually all incoming direct investments in any sector of the economy deemed vital to the security of the United States.

Driving this policy development was the strengthening belief among many government officials that, in the post-Cold War era of "peace and prosperity," economic competitiveness and technological leadership in the commercial sphere are urgent matters of national security. As earlier in the 1970s, however, the realization by elected policymakers of the potential utility of the inward foreign direct investment controversy in electoral politics and their struggle to control the machineries of government critically determined the scope and direction of the U.S. inward foreign direct investment policy:

Once again, the politics of structural choice left an indelible mark on the U.S. inward foreign direct investment policy.

Linking Investment with Trade

With regard to the politics of economic competitiveness discussed in the previous chapter, it has been the microeconomic dimension of the U.S.-Japan economic relationship that has fueled constituents' appeals to their elected officials, delivery on which demonstrates the ability of those in power to "do something." Because foreign direct investment has become just as important to many firms as a way to reach markets overseas, by the mid 1980s, many U.S. businesses began complaining to elected officials in Washington about the lack of direct investment opportunities in Japan. To some American businesses, the many obstacles to making direct investments in Japan was a grievance just as important as the lack of success in exporting to Japan.

Indeed, the investment gap between Japan and the United States was such that, by the late 1980s, it became impossible for many policymakers to ignore the inequity in the U.S.-Japan bilateral investment relationship.[1] Furthermore, there was growing awareness among elected policymakers that international trade and direct investment issues were intimately linked because so much of the world trade in both goods and services were now

[1]The discussion here of the imbalance of U.S.-Japan direct investment has benefited from Encarnation's *Rivals Beyond Trade*.

intra-company transactions, that is, goods and services exchanged among a single company's multinational operations.

These politicians also came to the conclusion that United States' open-door policy toward direct investment was not universally reciprocated and that new policy measures were needed to "level the playing field." As with trade, Japan was identified as a major offender. To many policymakers, particularly those in Congress, the lopsided investment relationship was yet another "proof" of Japan's unfairness in its commercial dealings with the United States.

Table 10.1

Role of foreign direct investment in the economies of the G-5 Countries, 1977 & 1986

(percentages)

Share of Foreign-owned firms	1977	1986
United States		
In sales	5	10
In mfg. employment	3	7
In assets	3	9
Japan		
In sales	2	1
In mfg. employment	2	1
In assets	2	1
France		
In sales	24	27
In mfg. employment	18	21
In assets	n.a.	n.a.
Germany		
In sales	17	18
In mfg. employment	14	13
In assets	17	17
United Kingdom		
In sales	22	20
In mfg. employment	15	14
In assets	n.a.	14

Source: D. Julius and S. Thomsen, "Foreign-owned Firms, Trade, and Economic Integration," *Tokyo Club Papers 2* (London: Royal Institute of International Affairs, 1988).

The evidence is quite clear that Japan has been remarkably closed to foreign direct investment. And as many have complained, this is largely due to the fact that, until recently, the Japanese government simply restricted inward foreign direct investment.[2] As one of the central elements of Japan's postwar developmental strategy, the Japanese government had used its power to bargain with foreign investors from the standpoint of a monopsonist. It employed strict restriction of inward foreign direct investment and technology transfer to help domestic industries achieve international competitiveness. Of course, by the early 1980s, Japan had removed almost all legal barriers to investment; however, there remained still other, more intractable, barriers.

Not surprisingly, Japan' notorious *keiretsu* system of oligopolies has not helped the prospective foreign investor. Because of the extensive cross-holding of stocks among Japanese firms through highly organized industrial groups, mergers and acquisitions, never mind hostile takeovers, are rare in comparison to such practices in the United States.

Table 10.2

Mergers and acquisitions involving Japanese firms, 1988-92

Year	JP firms acquiring JP firms	JP firms acquiring non-JP firms	Non-JP firms acquiring JP firms
1988	161	270	7
1989	172	408	10
1990	341	450	10
1991	386	257	12
1992	387	165	32

Source: Nomura Research Institute, *Quarterly Economic Review*, various issues.

[2]In the early part of the postwar period, the Japanese government placed sever limits on converting domestic earnings to foreign exchange for repatriation and then later established a highly restrictive approval system for inward investment.

Of course, there is always the "greenfield" option for the foreign investor. That is, foreign investors can establish new businesses from "scratch" without acquiring preexisting domestic businesses or assets. In practice, however, the extremely high cost of doing business in Japan in terms of both business and regulatory factors has also greatly curbed such investments.

Obviously, these obstacles have placed foreign firms in great disadvantage because they are unable to implement the full range of business strategies that are available in other markets. The burden has been especially difficult for capital-intensive high-technology industries that require tremendous economies of scale, learning-by-doing, and technological externalities optimized by high volumes achieved by capturing a large slice of the global market.

Economic Security and Inward Foreign Direct Investment

Because of the fear that the United States was losing its leading-edge technologies and manufacturing base to Japan's adversarial commercial practices in the high-technology sector, by the late 1980s, many elected policymakers began to view the issue of inward foreign direct investment as a new kind of national security issue, an "economic security" issue. While orthodox neoclassical economists may value efficiency and consumer welfare above all else, those concerned about national autonomy place greater emphasis on where manufacturing takes place and who controls the production process. This is especially true with regard to the so-called "defense industrial base"-- any good, service, technology, or other input to the national economy whose denial could diminish the security of the state.[3]

In the early 1980s, a number of government-sponsored studies found evidence that the United States was becoming increasingly dependent on imports that might be critical to military mobilization.[4] The findings of these studies were widely publicized by the press and alarmed many in the United States; and, not surprisingly, elected policymakers in Congress became increasingly sensitized to the potential dangers in the internationalization of industries through foreign direct investment. When combined with the increasingly loud complaints of those adversely affected by globalization of markets and the growing public distrust of Japanese intentions, such findings raised the political payoff of anti-market policies.

While most attempts by all kinds of domestic industries adversely affected by competitive imports to use the Section 232 of the 1962 Trade Expansion Act granting trade protection for national security reasons had been unsuccessful, those by machine tools and semiconductor industries succeeded because politicians believed they were not just saving domestic jobs but industries that are crucial to the economic security of the country.[5] Likewise, the mounting evidence that the Japanese were investing heavily in

---

[3]The term "defense industrial base" means different things to different people, but there seems to be some consensus among national security specialists that it consists largely of the high-technology industries.

[4]See the report of the Defense Industrial Panel of the House Armed Services Committee, *The Ailing Defense Industrial Base: Unready for Crisis*, Report, 96th Congress, 2nd session (Washington, D.C.: U.S. Government Printing Office, 1980). Also, see Defense Science Board, *Report of the Task Force on Industrial Responsiveness* (Washington, D.C.: Department of Defense, 1980).

[5]With Section 232 of the Trade Expansion Act of 1962, Congress authorized the White House to impose trade restrictions in those instances where it believed that imports posed a danger to national security.

high-technology assets in the United States, while not allowing similar investments in Japan to foreigners, increased their fear that some Japanese direct investments might be undermining the future economic prospects of the United States. Consequently, some in Congress began proposing "defensive" legislations based on their suspicion that somehow technological development and diffusion critical to the competitiveness of the country were being affected by Japanese investments, placing at risk the future of American prosperity by allowing Japanese control of domestic production and technology.

Of course, the Japanese were not alone in acquiring U.S. assets in the high-technology sector. While foreigners have made direct investment in every type of business, certain industries have witnessed unusually heavy levels of such investment. According to one source, by the early 1990s, 98 percent of the electronic packaging business, 80 percent of production of the innards of "U.S.-made" computers, 75 percent of the robotics market, 50 percent of the consumer electronics market, and nearly 35 percent of the chemical market in the United States were in the hands of foreigners.[6]

However, the available data appear to support the argument that the Japanese have made acquisitions in the U.S. high-technology sector a special priority. Some critics of Japanese investments in the United States point out that, during the late 1980s and the early 1990s, the Japanese made numerous investments in capital-starved, but promising, startup high-technology companies.[7] They charge that the Japanese invested in these U.S. companies

[6]See Linda Spencer, "Foreign Investment in the United States: Unencumbered Access," Washington, D.C., Economic Strategy Institute, May 1991, p. 8.

[7]Those who are critics of Japanese investments often point to the example of Kubota. In August 1988, Kubota Limited of Tokyo unveiled one of the world's most advanced mini-supercomputers.

in order acquire their advanced technology "on the cheap" and ultimately eliminate U.S. competition in key industries.[8]

Table 10.3

High-technology acquisitions in the United States by country and by industry, October 1988-April 1992

By country	Number of acquisitions	By industry	Number of acquisitions
Total	608	Total	608
Japan	399	Advanced materials	63
U.K.	65	Aerospace	32
France	41	Biotechnology	27
Germany	17	Chemicals	54
Canada	14	Computers	142
Switzerland	14	Electronics	56
Taiwan	11	Semiconductor equipment	39
Australia	7	Semiconductor	60
South Korea	4	Telecommunications	64
Netherlands	3	Other	71

Source: Linda M. Spencer, *Economic Strategy Institute Database*, May, 1992.

The experience of the U.S. semiconductor and semiconductor equipment industries-- an industry segment that many consider strategically critical to a growing range of major industries, including consumer electronics, weapons systems, and computers-- lends some support to such

The largest manufacturer of farm machinery in Japan, Kubota supposedly acquired all the technology in its new computer from American sources through a series of shrewd investments in a number of small, capital-starved Silicon Valley companies. By investing mere 75 million dollars in a handful of American startup firms, this Japanese maker of tractors bought the know-how to develop its own supercomputer. See David E. Sanger, "Kubota's Strategy Sparks Fears About Technology Losses," *New York Times*, September 7, 1988.

[8]See Tolchin, *Buying into America*, p. 11.

charges. In a study released in May 1991, Commerce Department's Office of Industrial Resources Administration warned that one factor contributing to the loss of U.S. technological and industrial leadership was high levels of foreign investment through acquisitions throughout the semiconductor supply chain. The report argued that U.S. semiconductor equipment companies were especially vulnerable to foreign takeovers because of their small size and command of attractive niche technologies. The report warned that even minority acquisitions could lead to the loss of homegrown innovations through technology transfers.[9]

Table 10.4

Japan's high-technology acquisitions in the United States, October 1988-April 1992

Industry	Japanese acquisitions	Total foreign acquisitions	Jp.acquisitions as % of total
Total	399	608	66
Advanced materials	40	63	63
Aerospace	19	32	59
Biotechnology	17	27	63
Chemicals	25	54	46
Computers	93	142	65
Electronics	33	56	59
Semiconductor equipment	30	39	77
Semiconductor	51	60	85
Telecommunications	31	64	48
Other	60	71	85

Source: Linda M. Spencer, *Economic Strategy Institute Database*, May, 1992.

[9]Bureau of Export Administration, Office of Industrial Resources Administration, U.S. Department of Commerce, *National Security and the State of the U.S. Industrial Base* (Washington, D.C.:U.S. Government Printing Office, 1991).

Given such evidence, many policymakers in Congress became convinced that domestic high-technology industries, such as semiconductor and allied industries, needed "protection" because they were strategically vital to the future growth of knowledge-intensive industrial development within the U.S. economy. They were persuaded by arguments such as that semiconductors-- as the "core" components of high-technology products-- could very likely determine the future development of a country's computer, telecommunications, robotics, aerospace, and other high-technology industries. They rejected the orthodox economic argument that there was no difference between a potato chip and a computer chip.

Such way of thinking, however, was not limited to those in Congress. Indeed, the voice of the "techno hawks" in the executive branch also grew louder and more influential as the Japanese gained more ground in the economic competition with the United States. For example, in 1984, William Casey, the director of central intelligence, denounced what he considered Japanese "incursions" into the U.S. computer industry (specifically the Hitachi-National Semiconductor and Amdahl-Fujitsu links) on the ground that they compromised the economic future of the United States.[10]

The more ardent techno hawks advocated new commercial policies based on the assumption that the very ubiquity of the semiconductor confers an overarching importance on all aspects of its design, development, and production and that the ability to design and produce sophisticated semiconductors creates with it a technological ripple effect, a synergy that stimulates research and development in other fields. Some of them even

---

[10]Speaking before the Commonwealth Club, Casey made no criticism of acquisitions by British, French, or German firms in the U.S. high-technology sector. See *Japan Economic Journal*, October 30, 1984.

proposed policies based on the more radical argument that there was a feedback mechanism by which consumer electronics and other civilian-sector markets ensured continued growth and development of the semiconductor industry. Since the U.S. consumer electronics industry had become reduced to irrelevance by Japanese competition and the U.S. military needs and purchases no longer set the pace in electronics advancement, they argued that the U.S. government had to enact "industrial polices" that would foster such emerging dual-use technologies as the high definition television (HDTV).[11]

Of course, there are limits to what policies are possible given the legacy of liberal internationalism in the United States: Given the constellation of domestic political forces and the pervasiveness of the liberal economic ideology, there are limits to government activism in protecting and nurturing domestic industries-- no matter what the reason. One the other hand, the scope of U.S. industrial policy, past and present, is often underestimated. Indeed, during the 1980s, these factors did not preclude the establishment of Sematech, a controversial government supported industry-wide consortium to develop techniques for manufacturing the next generation of commercial semiconductor devices.[12]

---

[11]Military requirements now lag behind civilian capabilities, according to the National Research Council (NRC). See "American Weapons, Alien Parts," *Science*, October 10, 1986.

[12]Sematech was established to improve the quality of American semiconductor manufacturing equipment and techniques. In 1987, with the blessing of the Reagan White House, Congress agreed to fund 100 million dollars a year for the consortium made up of 14 members contributing the same. The capital was to be used to build and run a model chip plant and provide research and development grants to equipment suppliers and purchase their equipment for evaluation and improvement. The justification was that a further weakening of the domestic equipment industry would have meant the chip makers' total dependence on Japanese equipment makers who were alleged to routinely hold back state-of-art equipment from the open market to give the Japanese chip makers the advantage.

Employing the argument that, without a healthy commercial semiconductor industry, the United States would have difficulty in sustaining the superiority of its armed forces, a coalition of policymakers in the executive branch and Congress was able to provide some government support to the beleaguered industry.[13] In fact, just prior to the creation of Sematech, applying the same economic security logic, these policymakers managed to prevent the Japanese takeover of a major, U.S.-based semiconductor maker. This was the first of a number of government intervention against Japanese direct investments in the high-technology sector, and it marked the beginning of a new U.S. policy stance toward incoming direct investments.[14]

The Fairchild Case

In October 1986, Donald Brooks, the president of the ailing Fairchild Semiconductor Corporation announced that the venerable firm, the progenitor of numerous other U.S. high-technology companies, was to be sold to Fujitsu Limited, a giant Japanese manufacturer of computers and semiconductors.[15] Fujitsu's plan to buy Fairchild marked one of the most significant transactions involving the transfer of cutting-edge U.S.

---

[13]The fact that Sematech was politically possible was because the connection between Sematech and U.S. national security appeared reasonably clear. See the report of the Defense Science Board Task Force, *Defense Semiconductor Dependency*, especially, pp. 26-84.

[14]Actually, early in the 1980s, the U.S. government reviewed the the proposed 110 million dollar sale of New Hampshire Ball Bearings to its Japanese competitor, Minebea. The transaction was studied by CFIUS which approved the deal with a condition that production of defense-related ball bearings would remain in the United States. Tolchin, *op. cit.*, p. 9.

[15]The discussion here of the Fairchild deal has benefited from the account offered by Fred Warshofsky, *The Chip War: The Battle for the World of Tomorrow* (New York: Charles Scribner's Sons, 1989), pp. 301-33.

technology, research, and expertise to Japan in decades and created the first major controversy over Japanese high-technology acquisitions in the United States.[16]

The announcement of impending sale of Fairchild to the Japanese sent a shock wave throughout the industry.[17] Cray Research, then the largest domestic maker of supercomputers and perhaps the world's technological leader in the field, was particularly alarmed. It had been working on a new family of supercomputers, and critical to the new machines was a new generation of high-density logic chips that performed arithmetic calculations at very high speeds. Cray, which used Fairchild logic chips in their current line of supercomputers, was also working with Fairchild as well as with Texas Instruments and Motorola on this new generation of chips.

Fujitsu's takeover of Fairchild placed Cray in a highly uncomfortable situation because the Japanese firm was its major competitor in the supercomputer market. Fujitsu, also a supplier of logic chips to Cray, was explicitly excluded by Cray from participating in the development of a new generation of chips because Cray was fearful of sharing its proprietary circuit designs with a company that was not only its supplier of vital logic chips but a major competitor in the supercomputer market. With the proposed takeover, it appeared likely that Fujitsu would gain direct access to Cray's

[16]Some have argued, however, the transaction was more important for symbolic significance, not so much for the technology transfer.

[17]Fujitsu proposed to pay 250 million dollars in cash for 80 percent of the company that had only the year before had its book value drop from 800 million dollars to 315 million dollars. Fujitsu also agreed to a capital infusion of 400 million dollars.

research by acquiring Fairchild.[18] Cray let its fears be known in Washington.[19]

There were many sympathetic ears in Washington, even in the ideologically pro-market administration of Ronald Reagan. Among the executive bureaucracies, there were some in the Defense Department, the National Security Agency (NSA), and the Central Intelligence Agency (CIA) who were concerned by the prospect that the Japanese were acquiring one of the U.S. government's key suppliers of vital surveillance and communications devices.[20] However, there were also those in the defense and the intelligence establishment who felt that the Fujitsu-Fairchild deal represented an opportunity to improve the U.S. defense technology base by tapping into Fujitsu's advanced capabilities.

The first official debate about what position to take toward the pending sale of Fairchild took place in a rare meeting of CFIUS which had been more or less dormant since its creation in the 1970s.[21] The debate among the working committee members of CFIUS was reported as intense and emotional, and those involved could not resolve the conflicting viewpoints

---

[18]Jack Robertson, "Say Near-Buy of Fairchild Periled Cray R & D," *Electronic News*, March 30, 1987.

[19]Fujitsu attempted to address those fears with a deal to supply Cray with the key chips for five years, and Brooks indicated that Fairchild was prepared to license its chip-making process to other companies so that a diversity of suppliers would be maintained.

[20]The supercomputers have numerous defense/intelligence applications; for example, they are used extensively for intercepting and decoding international communications. Also, Fairchild, at the time, was still a major supplier of chips to the military.

[21]In fact, the Fujitsu's offer to buy Fairchild was the only foreign investment CFIUS considered in all of 1986.

of the various agencies and officials involved.[22] Consequently, the matter had to be considered and resolved by the White House.

At a White House meeting in March 1987, Secretary of Defense Casper Weinberger and Secretary of Commerce Malcolm Baldridge recommended to President Reagan that he should personally intervene and forbid the transaction from taking place. They argued that the Fujitsu-Fairchild transaction was a test case where if the Japanese were allowed to consummate the transaction, the message would be that Japan can expect to purchase any asset in the United States without the interference of the U.S. government even if it meant the Japanese gaining effective control of the semiconductor industry.[23]

While this kind of nationalist argument had certain appeal to many working-level officials in the executive branch, it was countered by a combination of free market ideology and pragmatism espoused by many high-level Reagan appointees and advisers. Of course, one group of these officials-- especially from the Defense and Commerce departments-- saw the deal as a threat to the long-term economic security of the country and to the technological leadership vital to sustaining the nation's military capabilities.

---

[22]For more details, see Art Pine, "U.S. Considers Challenging the Merger of Schlumberger and Fujitsu Chip Units," *Wall Street Journal*, October 31, 1986 and Mike Tharp, "Uncertainty on Fairchild-Fujitsu Plan Grows as Justice Agency Begins Review," *Wall Street Journal*, November 17, 1986.

[23]"2 In Cabinet Fight Sale to Japanese," *New York Times*, March 12, 1987. Indeed, many in the Defense and Commerce departments shared the sentiment of Stephen Bryen, a deputy undersecretary of defense and a specialist in international security affairs, who felt that "If one of the flagship companies of our semiconductor industry could fall into the hands of the Japanese, we could end up with no U.S. semiconductor industry. We could lose the technology race by default." See Donna K. H. Walters and William C. Rempel's "Trade War: When Chips Were Down," *Los Angeles Times*, November 30, 1987.

However, many powerful White House aides saw in such a view harmful government interference in the natural functioning of the market.

Furthermore, the top political as well as career officials in the powerful Treasury and State departments expressed their fears that offending the Japanese would have an adverse impact on the nation's financial and diplomatic affairs. They voiced the opinion that the federal government should stay out of the transaction because of the nation's need for foreign capital, particularly from the cash-rich Japanese, to underwrite the federal budget deficit. They also warned that political interference in a commercial transaction between two private parties could undermine the U.S. effort to persuade the Japanese and other nations to remove their trade and investment barriers.

The anti-intervention group also had other bureaucratic allies within certain quarters of the Defense Department and on the influential National Security Council (NSC). Supporters of the deal in the NSC and the Defense Department felt that the time was ripe for increasing the level of U.S.-Japan security cooperation through technology sharing and co-development arrangements such as the FS-X fighter project. They had no problem with deals such as the Fairchild-Fujitsu transaction if assurances could be obtained from the Japanese that they would share technology and other resources as part of the transaction.[24]

Given this deep division within his administration, President Reagan could not readily reach a decision. The deadlock was broken when the transaction became public and the resulting reaction was overwhelmingly

---

[24]See Walters and Rempel, "A One-Time Winner Is Out of Chips," *Los Angeles Times*, December 1, 1987.

negative, bringing Congress into the policy debate. Without question, the press leaks by the opponents of the deal helped to stir up nationalistic public opinion and invite congressional scrutiny.

Up to this point, no Japanese investment in the U.S. high-technology sector received the kind of adverse publicity the proposed Fairchild transaction did. There was much anti-Japanese editorializing in the leading newspapers. For example, William Safire, in opposing the sale of Fairchild to Fujitsu, reminded the readers of his column in *The New York Times* that "Japanese businessmen were accused of stealing secrets from IBM and are suspected of technology diversions through Hong Kong."[25]

The press coverage of the transaction as well as the resulting negative public reaction invited a strong response from Congress. Soon after the deal became public knowledge, many in Congress began decrying the deal as a "sellout." For example, Senator James Exon, a Nebraska Democrat and a member of the Armed Services Committee, came out strongly against the proposed sale of Fairchild. He inveighed against the deal because he felt that "a major vendor of vital components to the U.S. Defense Department and the sole supplier of certain devices which are vital to important defense programs would be lost to the Japanese."[26] Also, a veteran of the earlier effort to regulate foreign direct investment in the United States, Senator Howard Metzenbaum, an Ohio Democrat and an influential member of the Judiciary Committee, warned that the deal could permit the Japanese to dominate the U.S. supercomputer market.

---

[25]William Safire, "Goodbye, Mr. Chips," *New York Times*, January 26, 1987.

[26]Michael Malone, "Fear and Xenophobia in Silicon Valley," *Wall Street Journal*, February 23, 1987.

Embolden by the negative reaction to the deal in the press and Congress, in a highly unusual move, Commerce Secretary Baldridge publicly condemned the deal and claimed that he was drawing "a line in the sand."[27] This denouncement and increasing congressional opposition to the deal made a deep impression on the Japanese who tend to prefer business dealings to be discrete and cordial. Five days after Baldridge's statement, Fujitsu backed out of the deal.[28]

Of course, the irony of the Fairchild-Fujitsu controversy was that Fairchild was not an American company when it received Fujitsu's bid. In fact, the firm was a wholly-owned subsidiary of a French company, Schlumberger Ltd., a giant, multi-billion dollar, oil-field exploration and equipment concern headquartered in Paris.[29] It was also questionable, despite the rhetoric of those opposed to the deal, whether Fairchild was producing

---

[27]Walters and Rempel, "Trade War: When Chips Were Down."

[28]Given the tremendous public controversy stirred up by the proposed transaction, the management of Fairchild first tried to restructure the deal. In fact, Donald Brooks, with some of his key executives, proposed a management buyout financed in part by Citicorp Venture, Intergraph Corporation (a company using Fairchild's Clipper microprocessor), and Fujitsu. According to the terms of the new deal, Brooks would remain firmly in control, and Fujitsu would receive 20 to 30 percent of Fairchild and, as a minority shareholder, it would have no say in the day-to-day operation of the company. However, fearful of fanning protectionist sentiment in the United States, Fujitsu pulled out of the deal with some pressure from the Japanese government. Warshofsky, *op. cit.*, p. 309.

[29]In 1979, Fairchild Semiconductor Corporation was sold to the French-owned Schlumberger Ltd. Fairchild could not quite recover from the defections it experienced earlier when many of its original engineers and technocrats, such as Charlie Sporck, Jean Hoerni, and Bob Noyce, left to form their own companies. When a large U.S. electronics systems maker, Gould Inc., was shopping for a semiconductor manufacturer, the Fairchild board turned to a "white knight," Schlumberger Ltd., to acquire the firm. When the revenues from the main part of its business suffered because of the declining oil prices, Schlumberger decided to sell the loss-making Fairchild to Fujitsu which made a generous offer for 80 percent of the company and gave hope for making Fairchild a competitive company again with a new infusion of money and technology.

products that were somehow indispensable to the national security of the United States.

The real driving forces behind the controversy were Japan's commercial misdemeanors in the eyes of many in the Untied States, the increasing technological prowess of Japanese industries, and the fear that a major segment of the domestic semiconductor industry was falling into its archrival's hands. These concerns regarding the Fairchild deal provided enterprising politicians with the first major opportunity to demonstrate their displeasure with the investment aspect of already raucous U.S.-Japan commercial relations. That is, the opposition to the deal had overriding symbolic importance that transcended the actual facts of the deal. Indeed, the transaction served to galvanize those policymakers in Congress who wanted to overhaul the U.S. policy toward foreign direct investment in order to meet the new imperatives of economic competitiveness. The stage was now set for revisiting the compromise that created CFIUS during the Ford administration.

CHAPTER ELEVEN

Compromise Revisited

By the time Fujitsu retracted its offer to buy Fairchild, elected policymakers in Washington were once again deeply involved in reexamining the U.S. policy toward inward foreign direct investment. Indeed, the public furor unleased by the ill-fated Fairchild-Fujitsu deal only served to galvanized those policymakers already concerned about the rapidly accelerating flow of direct investments coming into the United States. As it was the case during the 1970s, the vortex of policy activism in Washington was centered in Congress. The discussion here focuses on this legislative activism that has produced the current U.S. policy posture toward inward foreign direct investment.

The Bryant Amendment

Months before the Fairchild transaction was announced, there were already signs that Congress was worried about the new influx of direct investments coming into the United States. One indication was that, in May 1986, Representative John Bryant, a Texas Democrat representing a blue collar enclave in East Dallas, sponsored a legislation titled "The Foreign Investment Disclosure and Reciprocity Act."[1] The primary goal of his bill was to stiffen the reporting requirements on foreign investment.[2]

The Bryant bill called for mandating foreign investors to publicly disclose who was the true investor behind the investment as well as the source of financing and to register all new investments with the Department of Commerce. The bill sought to penalize any investor who attempted to hide behind dummy corporations or some "official secrecy" reasons. Beyond the disclosure objective, the bill proposed to restrict any new foreign investment in domestic assets unless American citizens were able to invest in the foreign investor's home country on equal terms.

White House Opposition

The House hearings on the Bryant bill were just taking place when Fujitsu announced its bid for Fairchild, adding a level of interest in these hearings that might not have been there had not the Fairchild deal attracted the kind of press attention that it did. Although the Reagan administration

---

[1]There is a good history of the Bryant amendment in Tolchin, *Buying into America*, pp. 223-46.

[2]Of course, there was still an earlier effort to regulate inward foreign direct investment. In the Senate, John Danforth, Republican of Missouri, linked investment to trade issues in Title III of the Trade and Tariff Act of 1984. Initially introduced in 1982 as the "Reciprocal Trade and Investment Act," the bill finally passed in 1984 with Title III renamed the "International Trade and Investment Act." A key provision of the law gave the USTR the authority to block products from entering the U.S. market if foreign performance requirements have been imposed by the host country. It put the machinery in place to identify investment barriers by requiring the USTR to submit annual reports that will "identify and analyze key barriers to U.S. trade in products, services, and investment." In other words, the law added investment barriers as a cause of presidential action, but it was not designed to address foreign direct investment in the United States as an issue in itself. See *Congressional Record*, 98th Congress, First Session, Vol. 129, No. 4-part III, January 26, 1983, pp. 1-7; and *Congressional Record*, 98th Congress, Second Session, Vol. 130, No. 132, October 9, 1984, p. 1.

was divided on the question of whether or not the Fairchild-Fujitsu deal should be permitted to proceed, the White House was quite certain that it opposed Representative Bryant's bill.

Administration officials testifying at these hearings claimed that the current level of information required by the United States were perfectly adequate to the needs of the government. They argued that they saw no reason to systematize their data-gathering efforts.[3] Just as earlier administrations opposed Congress's attempt to gather more information about the true identity of foreign investors during the 1970s, the Reagan White House opposed Congress's latest attempt. At these hearings, its senior officials rehashed the argument that data gathering is useless exercise that only leads to more paperwork and unneeded regulation.

The White House was even more emphatic about its opposition to the reciprocity provision of the Bryant bill. Robert Cornell, the deputy assistant secretary for trade and investment policy at the Treasury Department, testified that, if the bill passed into law, it would surely discourage the inflow of investments and encourage retribution from other countries. He pointed out that binding international treaty obligations required that the United States accord national treatment-- that is, the same legal treatment offered to domestic investments-- to most foreign investments.[4] Of course, there were some Reagan aides who viewed the overall aims of the bill in a more

---

[3]U.S. House of Representatives, "Disclosure of Foreign Investment in the United States," hearing before the Subcommittee on Telecommunications, Consumer Protection, and Finance, Committee on Energy and Commerce, 99th Congress, 2nd Sess., on H.R. 2582 and H.R. 4242, serial no. 99-125, May 8, 1986.

[4]*Ibid.*

favorable light. However, their views were suppressed by the White House during its campaign against the reciprocity provision of the Bryant proposal.[5]

Given the particularly strong opposition to the reciprocity provision of the Bryant bill by the Reagan White House, that provision was soon dropped. The Bryant bill was resubmitted with thirty-one cosponsors on January 7, 1987, as H.R. 312, renamed the "Foreign Ownership Disclosure Act."[6] Nonetheless, the bill still faced a strong opposition from the White House. The fact that there was resistance to the bill even within Congress did not help Representative Bryant's cause.

Partisan Conflict

In the House

The opposition from the House Republicans was particularly severe. In March 1987, when Bryant managed to attach a modified version of his proposal to the omnibus trade bill then under consideration in the House Energy and Commerce Committee, the extent of the opposition was revealed.

The modified amendment would require that a foreign investor purchasing more than 5 percent of a U.S. business or real estate with asset value over 5 million dollars or annual revenues over 10 million dollars provide information about identity, nationality, address, date when interest was acquired, percentage of investment and purchase price, name and location of U.S. property, and terms and conditions of acquiring interest.

---

[5]For example, Richard N. Perle, the Defense Department's assistant secretary for international security, was denied clearance by the White House to testify before Congress on the issue of foreign direct investment because his view differed from that of the White House.

[6]*Congressional Record*, January 7, 1987, pp. H 157 & E 71.

Those with a "controlling interest"-- with over 25 percent in a U.S. business with assets or annual revenues over 20 million dollars-- would additionally have to provide information regarding balance sheet, income statement, and other financial data.[7]

With the White House lobbying the Republicans on the committee with the argument that the amendment was anti-growth and discouraged investment flows both in and out of the United States, all Republicans on the committee voted against the Bryant amendment. Nonetheless, the amendment passed the committee by a margin of one vote.[8]

Of course, the narrow victory in committee was just "round one" in the legislative battle. The Republican opposition to the amendment only intensified on the floor. The securities industry, feeling threatened by the proposed new regulations on investment and the consequent possible slowdown of investments coming in from abroad, began to lobby members on both side of the House aisle.[9]

Norman Lent, the ranking Republican member of the Energy and Commerce Committee, attempted to "gut" the Bryant amendment by offering his own proposal to authorize the commerce secretary to exempt certain classes of investors or investments from the full impact of the amendment to prevent impairment of foreign investment in the United States. Lent argued that American jobs were placed in jeopardy by the Bryant provision.[10] Other

---

[7] Investment in bonds and other debt instruments would have been exempt from any reporting requirement.

[8] The vote was 21 to 20 for the amendment.

[9] The securities industry lobbying was led by First Boston.

[10] *Congressional Record-- House*, April 29, 1987, p. 2822.

Republicans, such as Representative Michael G. Oxley of Ohio, concurred that foreign investments created jobs and wealth in their home states and that it would be a mistake to placed obstacles such as the Bryant amendment in the path of incoming investments.[11] Of course, the pro-employment argument also resonated strongly with the Democratic members of the House, and this dimmed the survival prospect of the amendment.

Impact of the Fairchild Deal

With the public controversy surrounding the impending acquisition of Fairchild by Fujitsu, however, the Bryant amendment gained some support from those who were concerned about the security implication of lax policy toward inward foreign direct investment. Representative James Florio, a Democrat from New Jersey, argued that while the Bryant amendment could not stop Fujitsu's takeover of Fairchild, it would ensure that the government would know "whether a foreign person has a significant or controlling interest in a defense contractor with whom it is dealing."[12] Other Democrats, such as Representative Marcy Kaptur of Ohio, joined in with similar reasons for adopting the amendment.[13]

Indeed, the controversy created by the impending Fairchild deal saved the Bryant amendment in the House. With the support gained with the security argument, the amendment cleared the House floor without the modification proposed by Representative Lent, and Bryant found a Senate sponsor in Tom Harkin, a Democrat from Iowa with presidential ambition

---

[11] *Ibid.*

[12] *Ibid.*, p. 2823.

[13] *Ibid.*, p. 2848.

and a stake in the trade issue that was now central to the Democratic Party's national electoral strategy in 1988.

In the Senate

Though not surprised by the outcome in the House, the White House was alarmed by the survival of the Bryant amendment and pulled no punches in the Senate, sending such luminaries as Paul Volcker, the chairman of the Federal Reserve and James Baker, then the treasury secretary, to persuade the Senate of the folly of the amendment. The Reagan White House was determined to defeat the amendment, and its strategy now hinged on convincing the Senate that the amendment would limit the president's effort to persuade other countries to drop their investment barriers.

With the help of administration's ally in the Senate, John Danforth of Missouri, the White House also hinted that the amendment would inevitably force the president to veto the entire trade bill. This was a threat the Democrats could not take lightly. After all, they had much to lose politically, considering how much they had already invested in this image-making legislation that promised to buttress the Democratic Party's claim as being tough on trade and unfair foreign economic competition.

The Lobbyists

Also alarmed by the amendment's survival in the House was the securities industry, which would bare the immediate cost of the Bryant proposal. Hence, it intensified its lobbying effort in the Senate. This time, it was joined by other big business allies. Many U.S. headquartered transnationals, through their industry lobbying groups, let it be known that they were unhappy with the prospect of foreign backlash against their investment activities abroad. Representatives from organizations such as the Business Roundtable, the U.S. Chamber of Commerce, and the National Association of Manufacturers descended on the Hill and told the senators that the amendment would surely trigger retaliatory harassments from foreign governments.[14]

Naturally, a legion of representatives of foreign transnational corporations was also present in force while the amendment was under consideration. Indeed, in contrast to the situation earlier in the 1970s, the transnational business interest was well represented and very active on the Hill, a testament to the rapid globalization of markets as well as a greater, more immediate interest at stake for the international business community.

However, the domestic labor interest, again as in the 1970s, was not fully engaged in the policy debate and did not aggressively support the Bryant amendment. Of course, in principle, labor unions did support the Bryant amendment and produced a policy position. One of organized labor's arguments for the passage of the amendment was that "American workers and communities are often unable to find out even basic information about [foreign] firms' activities in the Untied States."[15]

Beyond such position taking, however, lobbyists for labor unions were pretty much absent from the corridors of the Capitol building. As earlier in the 1970s, the labor interest was split between workers who viewed foreign investment as a potential source of jobs and those who feared the

---

[14]Personal interview with a New York-based business lobbyist.

[15]Letter from Howard Samuel and David Mallino to members of Congress, April 28, 1987, Industrial Union Department, AFL-CIO. (Cited in Tolchin, *op. cit.*, p. 238.

displacement of union jobs by non-union jobs as foreign firms, particularly in the manufacturing sector, tended to invest in the "right-to-work" states of the Sunbelt.

Not surprisingly, given the forces marshalled against the proposal and the priority given to the safe passage of the larger trade bill by the Democrats, the Bryant amendment was voted down in the Senate. With many amendments to consider in the trade bill, there was no time for a committee hearing or other means for the Bryant amendment supporters to make their case.[16] After a short debate on the floor, the senators voted to strike the amendment from the trade bill by a vote of 83 to 11.

The Lessons and Implications

The fate of the Bryant amendment made it clear that it was extremely difficult to pass a law that affects the inflow of foreign investment in the United States in a blanket-like fashion, especially if it had any chance of inviting significant retaliatory action against U.S. investments and business activities abroad and/or inhibiting job creation in the United States. In Congress, such policies would inevitably solidify the potential losers from such a policy with the principled opposition from the mainstream Republicans who have used their advocacy of free trade to identify themselves as Republicans since the waning days of World War II.[17]

[16]Indeed, the supporters of the amendment complained that there was really no time to study the issue, let alone determine committee jurisdiction.

[17]Of course, this is in principle, not necessarily in practice.

However, the strong negative public reaction to the Fairchild-Fujitsu deal and the split the transaction caused in the executive bureaucracy as well as the relative effectiveness of the national security argument for the Bryant amendment employed in the House showed that economic security concerns and the fear of ascendent Japan at the heart of the inward foreign direct investment controversy could reach and bring together diverse political groups while neutralizing others. As with trade, which Tony Coelho claimed had become the Democratic "macho issue" of the post-Cold War era, inward foreign direct investment was identified by many Democrats as an important policy issue that could buttress their party's claim that it was tough on unfair foreign economic competition and economic security issues, but unlike trade protectionism, could appeal to a broader range of constituency (including many security-minded nationalistic Republicans) based on the more immediate implications the economic phenomenon had on national security.[18]

Moreover, the idea of more tightly regulating inward foreign direct investment had undeniable populist appeal, whatever its demerits economically: A 1988 opinion poll conducted for *The International Economy* showed that 74 percent of Americans surveyed believed that foreign investment has lessened U.S. economic independence. The poll also revealed that 78 percent favored a law restricting foreign investment in the United States and 89 percent wanted foreign investors to register with the

---

[18]A political party's identification with an issue may be compared to a brand name of a product. Since electoral politics in the United States revolve around the median voter because of the dynamics of a two party-single member district system, there is a strong tendency for parties to favor consistent policy line on a given issue which has an important impact on mass voting patterns. See the argument in Gary W. Cox and Mathew D. McCubbins' *Legislative Leviathan: Parties and Committees in the U.S. House of Representatives* (Berkeley: University of California Press, 1993).

government.[19] Clearly, the idea appealed to the insular, nativist streak in U.S. body politics.

Hence, being tough-- or just appearing to be tough-- on the inward investment issue had great allure for the Democratic party because the populist appeal of such a restrictionist policy stance held the promise of attracting votes from a broad electoral base with relatively low cost, "soft" symbolic policy measures. It could be argued that, compared to providing more costly distributive policy measures requiring the delivery of specialized benefits to help concentrated groups at the expense of others (as with trade protectionist policies, for example), appearing to be tough on foreign direct investment had a similar political attraction for politicians as appearing to be tough on crime or communism.

However, it must also be kept in mind that, as part of the larger politics of economic competitiveness discussed earlier, many politicians realized that the defining of the inward foreign direct investment issue as a matter of economic security had consequences, if indirect, for distributional politics as well. Indeed, if a tougher, more restrictive inward direct investment policy were adopted by the United States, the implication would be that there are industries and companies the U.S. government is not willing to have fall into foreign hands. The logical extension of such a policy would be then a more open embracement of a range of industrial policies, a rich potential source for distributional politics.

As discussed earlier, by the mid 1980s, the sources of political pressure on the U.S. foreign economic policymaking process were no longer limited to those who were clear losers in the globalization of markets. The old saying

---

[19]Thomas Omestad in "Selling Off America," *Foreign Policy*, No. 76, (Fall 1989), p. 119.

that "losers enter politics, while winners stick to business" had lost much of its validity. Many enterprising "Atari Democrats" were well aware that in the globalization game even winners in the high-technology sector needed government help in opening markets abroad and defending markets at home. And they also knew, as Bill Clinton did during his successful 1992 presidential campaign, that there were votes-- especially from the more educated workers of the high-technology sector whose political loyalty is considered contestable-- to be won in this new world of "export-market interest and import-market anxiety," if they could be seen as providing the help needed.[20]

The Exon-Florio Amendment

While the Bryant amendment was drawing fire from numerous sources, Representative James Florio and Senator James Exon, both Democrats, introduced another amendment targeting foreign direct investment to the omnibus trade bill. This amendment was of a different type than the ill-fated Bryant amendment. Instead of blanket-like regulation on all foreign direct investments, this amendment gave discretionary power to the president to screen out only "undesirable" investments.

The Exon-Florio amendment called for the president to review foreign investments coming into the United States and to block any investment that threatened "economic security." Given the wording and the design of this legislation, it did not attract the level of opposition from business groups, the

[20]The phrase is from Destler, *American Trade Politics*, p. 190.

Republicans, and the executive branch that the Bryant amendment did. In this amendment, policymakers in Congress found a successful vehicle for forcing the White House to pay more attention to the competitiveness issue that many in Congress, Democrats as well as Republicans, felt was increasingly important to national security and to many industries and voters throughout the country.

Renegotiating the Compromise

The introduction of the Exon-Florio amendment in Congress, in effect, proposed to renegotiate the compromise reached during the mid 1970s between the policymakers in Congress and the White House that resulted in the creation of CFIUS. The final version of the amendment that eventually passed into law represented a new equilibrium point where the renewed policy struggle came to another political stalemate. It represented a new compromise where the conflicting goals of the policymakers in Congress who wanted a more activist approach to U.S. trade and investment policies and the White House which sought to defend its prerogatives in making foreign economic policy achieved a kind of Nash equilibrium.

The Struggle over the Provisions

As originally submitted by James Florio, then the chairman of the House Subcommittee on Commerce, Consumer Protection and Competitiveness, the amendment would authorize the president to block any foreign takeover of a U.S.-based firm that compromised not just security but the "essential commerce" of the United States. The proposal contained a checklist of factors the president had to consider in evaluating whether to approve a direct investment from abroad or not. Indeed, this amendment was specifically designed to get the attention of the White House.

As it was the case in the 1970s, the initial proposal was written in a way sufficiently objectionable to the White House so that the president would have to respond in some serious way to congressional concerns. Again, the goal of those in Congress was to delegate power to the president and have the executive agencies pursue at least some aspects of their most important concerns.

The provision requiring the president to block foreign investment in domestic assets that may harm the "essential commerce" of the United States immediately drew opposition from the White House. However, groups representing various business interests were either confused by the proposal or did not find this amendment as threatening as the Bryant amendment.[21] In fact, as one industry analyst recalls, some business groups such as the Semiconductor Industry Association liked the idea of a law designed to protect the "essential commerce" of the United States.[22] Hence, there was hardly the level of interest group opposition to this amendment when compared to the experience with the Bryant amendment.

However, with the amendment clearly charging the White House with a new responsibility that it did not ask for, there was opposition from the president. Beside the distaste President Reagan had for government

[21]The National Association of Manufacturers (NAM), for example, supported the amendment based on the belief that since Congress was going to pass some kind of a law targeting inward foreign direct investment, an Exon-Florio type of legislation was preferable to a Bryant type. Personal interview with a NAM official.

[22]Personal interview with a semiconductor industry analyst.

tempering with market forces, the administration argued that the Florio proposal would undermine its objective of reducing trade related investment measures (TRIMs) in the Uruguay Round of GATT talks. As all presidents complain, Reagan protested that Congress was seriously undermining the executive's ability to conduct foreign policy.[23] The White House argued that it did not want Congress to tie its hands on a "foreign policy" matter.

This opposition by the White House led to the insertion of the phrase "harm to national security" in the text of the amendment, giving the president more explicit discretionary power to block unwanted investments. Though this did nothing to address White House's substantive objection to the amendment, in this strengthening of the national security utility of the amendment, President Reagan found a reason, if not to like, not to object so strenuously against the amendment. Clearly, in moderating its opposition to the amendment, the White House revealed its preference for this kind of delegation of power where a new policy instrument was placed at its disposals to be used at the discretion of the president rather than the passage into law of bills such as the Bryant amendment that mandated broad sweeping changes.

Of course, despite the discretion granted to the White House, Congress was careful in preserving through the operative language of the bill its *ex post* power to judge the presidential use of delegated power. Indeed, some policymakers in Congress held to the position that the term "national security" could be interpreted to include "economic security" considerations such as the domestic production capabilities required for projected defense needs, the current abilities of domestic firms to meet these needs, and the

[23]Again, this White House attempt to emphasize the "foreign policy" nature of the investment issue is something the neostatists would focus on as the most salient feature of the making of U.S. inward foreign direct investment policy.

effect on the national security requirements of concentrations of foreign investment in various industries.

In the end, when the amendment reached the final House-Senate conference committee, the "essential commerce" clause was removed in the final statutory language. However, while the White House had its way in eliminating that particular clause, the newly inserted language about "national security" was left deliberately vague, making it difficult to specify the criteria to be used in deciding whether to initiate a government investigation. The wording of the text gave little guidance as to what would be considered important to national security, other than another ambiguous statement that the statute would apply to "products or key technologies essential to the U.S. defense industrial base." This, obviously, left open the possibility that "national security" would have to be defined on a case-by-case basis by the White House while being second-guessed by Congress.[24]

The Passage of Exon-Florio

Encountering little opposition from various interest groups that helped to defeat the Bryant amendment, the Exon-Florio amendment was passed into law with the passage of the Omnibus Trade and Competitiveness Act of 1988. However, while enacted as part of the larger omnibus trade act, it was technically an amendment to the Defense Production Act (DPA), an impermanent statute requiring periodic reauthorization by Congress.

---

[24]However, the accompanying conference report would appear to support the argument that the phrase should be interpreted broadly and not limited to investments in any particular industries. Also note that the term "defense industrial base" is not defined. Congress also managed to retain the language that the president was obligated to invoke the new authority if there was any "credible evidence" that the foreign investment may threaten to impair national security. See *Congressional Record*, 134, April 20, 1988, p. H2118.

Although the amendment was clearly intended to be a permanent law by its supporters, for tactical reasons, the sponsors of the proposal placed it in the DPA as a kind of insurance. They knew that its placement in the DPA would be a safe choice because never since its enactment had the DPA been allowed to lapse for any significant time.

The passage of Exon-Florio amendment represented a major development in the U.S. policy toward inward foreign direct investment. It ratcheted up the level of restrictions targeting inward foreign direct investment not seen since the pre-World War II period. As adopted, the amendment required the president to review mergers, acquisitions, and takeovers by foreigners when they were determined to be "sensitive" transactions and had a potential impact on national security.[25] It gave the president the authority to block foreign acquisition of U.S. companies that threaten to impair national security and, without any time limit, to compel divestment if the circumstance required it.[26]

Five types of transactions were subject to the provisions of the Exon-Florio amendment: First, contemplated or consummated investments that result or could result in foreign control of U.S. firms; second, tender offers whereby foreign investors offer to purchase a controlling stake in U.S. firms; third, contemplated or consummated acquisitions by U.S. firms currently under foreign control of other U.S. firms if the acquired firm then comes

---

[25]Section 721 of the Defense Production Act of 1950, 50 U.S.C. App. ss 2061 *et seq.*, as amended by Section 5021 of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. 100-102 Stat. 1107.

[26]Before the president can exercise this power, however, the White House had to find that there were no other provisions of law (expect for the declaration of an emergency under the International Emergency Economic Powers Act) that provided adequate or appropriate authority to protect national security.

under foreign control; fourth, proposed or completed acquisitions of U.S. businesses by foreign investors, that is, acquisitions where the acquired business does not constitute a "U.S. person," a circumstance that would arise if a U.S. firm were to sell an unincorporated division to a foreign investor; and fifth, joint ventures that could result in foreign control over the businesses of U.S. firms.[27] Greenfield investments were not covered by Exon-Florio, nor were portfolio investments and certain others where the foreign investor does not have control of a U.S. business.[28]

Interestingly, those who were for tighter regulation of inward direct investment as well as those who were opposed to any restriction argued that it was difficult to judge whether the passage of the Exon-Florio amendment into law represented a fundamental change in the U.S. policy toward inward foreign direct investment. However, it cannot be disputed that the law introduced unsettling uncertainties for the foreign investor in the U.S. policy that were not present previously. Indeed, in the law, there was much vagueness in what was meant by "national security"; hence, there was much leeway in the way the mandate of the Exon-Florio amendment could be carried out. The interpretation was left to the president; therefore, depending on the proclivity of the administration in power, the definition could be stretched or compressed.

Furthermore, the law placed in potential investors' path disclosure obstacles that would be onerous for some. For example, the investment review process required that foreign investors provide confidential data.

---

[27]Section 721 of the DPA as amended by Section 5021 of the Omnibus Trade and Competitiveness Act of 1988.

[28]Also, Exon-Florio would not apply to the sale to a foreign investor of a U.S.-owned business if that business were located entirely outside of the United States.

Such data could be made available to Congress and, possibly, from there, leaked to other parties. Besides, if an investment was found to be unacceptable, after weeks of uncertainty while the review was taking place, there was no possibility of appeal. Moreover, there was always the possibility that policymakers in Congress would decide to step into the review process by holding interminable public hearings on a proposed investment.

At the very least, the Exon-Florio amendment represented a significant extension of the blocking authority of the federal government. Of course, in principle, the possible grounds for blocking inward foreign investment were to be limited to national security considerations, but policymakers inclined to restrict investments could do so through a broader interpretation of what constituted national security. As many opponents of the law argued, prior to the amendment becoming law, the United States already possessed other means (perhaps not as flexible as the new law) to stop foreign investments on grounds of national security. Therefore, the screening mechanism established by Exon-Florio would necessarily focus on economic criteria in judging the value of a particular foreign investment and possessed, in its discretionary power to block investments, the ability to demand changes in the condition of investment before granting acceptance-- in effect creating a *de facto* mechanism that can impose performance requirements on foreign investment.

CFIUS Strengthened

By Executive Order 12661, President Reagan assigned the investment reviewing authority delegated to him by Congress under the Exon-Florio amendment to CFIUS, the key creation of the previous policy compromise between the White House and Congress on the inward direct investment issue. As President Ford created CFIUS as both a response to congressional pressure and a way of maintaining White House control of the implementation of an aspect of U.S. foreign economic policy, President Reagan reshaped CFIUS to meet the minimum requirement set forth by Congress in the Exon-Florio amendment and to maximize presidential control of the execution of the U.S. inward foreign direct investment policy.

This new responsibility of implementing the provisions of the Exon-Florio amendment gave the long dormant interagency panel the power to take substantive action for the first time.[29] With this responsibility, CFIUS's mission changed from one of coordination to that of policy enforcement. However, the White House was careful to retain political control of CFIUS, something it was not entirely successful in accomplishing.

White House Control and Its Limits

While the White House authorized CFIUS to handle all tasks necessary to implement the provisions of the Exon-Florio amendment, the president reserved for himself the final authority to approve or reject transactions

---

[29]The original executive order establishing CFIUS authorized it to (1) monitor and study trends in foreign investments, (2) negotiate advance consultations with foreign governments desiring to acquire assets in the United States, (3) review investments that may have national security implications, and (4) study new legislation or regulations on such investment. In its actual operation over years, however, its scope of operation was limited by the White House to the third mission. Furthermore, according to one former Commerce Department representative on CFIUS, for the first 13 years (1975-1988) of its existence, CFIUS operated "as an informal working group with procedures and protocols that were passed along from administration to administration by little more than word of mouth." See Joseph F. Dennin, "Getting Your Deal Past CFIUS: A Businessman's Guide to the Exon-Florio Review," *Foreign Investment In the United States, News and Analysis*, March 1989, p. 4.

reviewed by CFIUS.[30] Upon learning of a pending foreign direct investment, CFIUS had 90 days to determine whether the transaction posed any danger to the national security of the United States and recommend an appropriate course of action to the president.

This 90-day period was divided into three phases. In the first 30-day period, CFIUS had to decide whether a formal investigation was warranted.[31] In the second 45-day, if it decided an inquiry was required, CFIUS had to conduct all the investigations deemed necessary and make its recommendation to the president.[32] The last 15-day period was reserved for the president to decide what to do about CFIUS's recommendation based on its investigation. The decision to deny or permit was to be president's one alone.

This desire to keep CFIUS firmly under White House direction was even more obvious in President Reagan's expansion of the membership of the interagency panel. Reagan retained the treasury secretary as the nominal chair of CFIUS, but he enlarged the membership of the committee to include the heads of the Justice Department and the Office of the Management and Budget (OMB).[33] He added the Justice Department for a policy reason: He

---

[30]Actually, this presidential retention of the final authority to approve or reject transactions was required by law. Nonetheless, the president did not have to have made this retention of authority so explicit in "redesigning" CFIUS.

[31]If it decided against review, the transaction was deemed not to be blockable for reasons of national security, and the matter was to end as far as CFIUS was concerned (unless of course it should later become apparent that the decision was based upon falsified information or misrepresentation).

[32]If CFIUS could not reach an unanimous decision on whether the transaction should be blocked or not, it findings were to be submitted to the president with a statement of opposing views.

[33]Reagan enlarged the the membership to eight from existing six (the Treasury, State, Defense, and Commerce departments, the Council of Economic Advisers, and the Office of the U.S. Trade

wanted to include an antitrust element to CFIUS investigations. However, he included the OMB for a political reason: He wanted to strengthen White House's political control over the committee.

Also, in term of policy substance, revealingly, President Reagan did not give CFIUS the power to compel makers or receivers of investment to report the transaction, something many members of Congress wanted for the committee. Without this authority, CFIUS was dependent on buyers and sellers volunteering information and following press reports of acquisitions.[34] Under the procedures adopted, an investment of potential concern could be reported to CFIUS by any direct party to the transaction or by a CFIUS member. Thus, the decision to notify CFIUS of a transaction was left to the discretion of the parties directly involved the deal and CFIUS member agencies.[35]

Nonetheless, the measures taken by the White House to keep a tight reign on CFIUS did not make CFIUS either "toothless" or invulnerable to extra-administration influences. There were features in the empowering legislation as well as the design of CFIUS itself that made the panel surprisingly effective as a screening agency and susceptible to political

---

Representative). The Council on International Economic Policy was eliminated during the Cater administration.

[34]A former CFIUS staff member admits that many cases came to CFIUS's attention on an *ad hoc* basis, through the press, commercial competitors, and concerned members of Congress. Personal interview.

[35]One Defense Department official expressed the concern that foreign acquisitions--particularly of relatively small, closely held U.S. companies without classified contracts--"might well fall through the cracks and occur without the knowledge of CFIUS," but, on the whole, the possibility of something like that happening appears remote. The testimony of Assistant Deputy Under Secretary for Defense Peter M. Sullivan before the House Subcommittee on Commerce, Consumer Protection and Competitiveness of the Committee on Energy and Commerce, Washington, D.C., March 19, 1990, p. 30. (Cited in Spencer, "Foreign Investment in the United States: Unencumbered Access," p. 10.)

pressures from non-administration sources, particularly the policymakers in Congress.

Although under the procedures established by the White House the decision to notify CFIUS of a particular transaction was left to the discretion of the direct parties involved and CFIUS member agencies, in practice, other parties could call the transaction to the attention of CFIUS. Although this would not constitute a formal notification, such a possibility limited the discretion of the direct parties involved and the administration. And if CFIUS should prove not very receptive to an unsolicited "notification" by a third party, the transaction could always be brought to the attention of Congress.

Furthermore, if the parties to a transaction that might be deemed subject to review under Exon-Florio failed to notify CFIUS, and the transaction initially escapes its attention, CFIUS could review the transaction at virtually any time it chose. If CFIUS then recommended divestment, and the president agreed, the divestment could be forced retroactively, a costly consequence for any investor.[36] Hence, the parties had some strong incentives to "voluntarily" notify CFIUS.

In addition, as the law was written by Congress, CFIUS could investigate foreign direct investment in almost all industries. Of course, the Exon-Florio amendment reflected the understanding of its authors that some products or services had no special relations to national security; however, the amendment did not clearly spell out what products or key technologies

---

[36]For this reason, parties to any transaction that might be deemed subject to review under Exon-Florio have been routinely advised by their legal counsel to notify CFIUS voluntarily before closing the deal.

were essential to the U.S. defense industrial base. Hence, no activity or industry could be automatically excluded from CFIUS's purview.[37]

Furthermore, the operating guideline established for CFIUS that intended to give the president maximum discretion contained no rules or tests that could be used to determine unequivocally what products, services, or technologies fell into this category of defense industrial base. CFIUS could, therefore, take a broad or a narrow interpretation of what activities and industries were of relevance to national security. This very vagueness in CFIUS's operating procedure allowed political pressure to be exerted by Congress on CFIUS investigations. The vagueness, while giving discretionary power to the president, also allowed for congressional interpretation of what constituted the national security of the United States. Indeed, it allowed for constant congressional second-guessing of White House decisions.

CFIUS in Action

Although CFIUS has been criticized by its supporters as well as its detractors as ineffective, the truth is that it has been surprisingly effective with regard to certain tasks. Indeed, it has served as a *de facto* screening mechanism for investments and, in some cases, a device for setting performance requirements.

---

[37]Exceptions are products and services such as toys, food, restaurants, legal services, and few others.

The CATIC-MAMCO Case

From the date that it was authorized to carry out the requirements of Exon-Florio to the summer of 1992, CFIUS reviewed over 700 proposed transactions, and, out those, 14 were formally investigated.[38] In only one instance prior to the LTV-Thomson case did CFIUS recommend to the president that the transaction should be blocked.[39] That one negative recommendation involved blocking an acquisition of a U.S. aerospace manufacture by a Chinese company after the Tiananmen Square massacre of June 1989.

On November 6, 1989, China National Aerotechnology Import and Export Corporation (CATIC), an entity owned by the Chinese government informed CFIUS that it proposed to acquire for about 20 million dollars MAMCO Manufacturing Inc.[40] By the end of that month, CATIC closed the deal and acquired the Seattle-based company which machines and fabricates

---

[38]By the end of 1992, CFIUS had formally investigated the transactions involving these companies: (1) Huels AG/Monsanto Electrical Materials Co.; (2) Tokuyama Soda/General Ceramics; (3) ABB/Westinghouse; (4) Matra/Fairchild Industries; (5) Lalbhai Company/Tachonics Corporation; (6) China National Aero-Technology Import and Export Corporation ("CATIC")/MAMCO Manufacturing Inc.; (7) UniSoft/CMC; (8) BTR/Norton; (9) Saint-Gobain/Norton; (10) Nippon Sanso/Semi-Gas; (11) follow-on CATIC/ MAMCO divestiture transaction; (12) Fanuc/Moore Machine Tool Corporation; (13) ASCOM-Mercedes Information Technologies/Unisys; and (14) Thomson/LTV.

[39]In the Thomson CSF S.A.'s ill-fated effort buy LTV Corp.'s missile business, the French firm withdrew its 300 million dollar offer for the American operation given the prospect of certain rejection by CFIUS. Besides, the opposition to the deal in Congress was fierce. Indeed, as a fallout of this case, the Exon-Florio amendment was strengthened in 1992. Democratic Senator Robert Byrd of West Virginia pushed through a legislation to strengthen the CFIUS process. That legislation, contained in the defense authorization bill that President Bush signed, requires that the president explain himself to Congress whenever he decides not to stop a sale. And it prevents foreign government-controlled companies from buying U.S. firms involved in certain defense procurement or classified work unless CFIUS explicitly approves them.

[40]CATIC, the purchasing agent of the Ministry of Aerospace Industry of the People's Republic of China, was involved in research and development and the design and manufacture of military and commercial aerospace products and systems.

metal components used in commercial aircraft. The firm was a supplier of small parts and fittings to the Boeing Company. While it owned some machinery that was subject to U.S. export controls, the firm was essentially a low-tech "metal bender" that depended on Boeing for most of its business.

Largely to express its displeasure with the Chinese government, the Bush administration decided to oppose the transaction. To the surprise of the critics in Congress who have been clamoring for a more aggressive interpretation and enforcement of the Exon-Florio amendment by the White House, on January 19, 1990, CFIUS recommended to the president that he should force CATIC to divest MAMCO.[41] On February 2, 1990, President Bush ordered CATIC to divest itself of MAMCO.

The White House argued that CATIC's ownership of MAMCO could jeopardize national security because there was a chance that the Chinese government could use MAMCO as a tool for espionage in the United States.[42] The administration made no mention of the fact that CATIC already owned other companies in the United States. The White House goal in this matter was two fold; first, to show Congress that the administration was "punishing" China for human rights violations and, second, to show Congress that CFIUS was not "toothless" as its critics claimed.

CATIC was ordered to complete the divestiture by May 1, 1990, but it took more than a year to find a buyer. The divestiture was completed on July 26, 1991. In the meantime, MAMCO was operated under a proxy arrangement

---

[41] Andrew Rosenthal, "Bush Urged to Void Sale of Airplane-Parts Maker to Chinese," *New York Times*, February 2, 1990.

[42] The intelligence community supposedly had information raising questions about CATIC's past activities, including its apparent attempt to reverse engineer General Electric jet engines sold to China in 1984.

similar to the requirements of the Department of Defense Industrial Security Regulation with respect to the performance of classified government contracts by U.S. subsidiaries of foreign-owned companies.

Naturally, the president's decision drew criticism from some international trade groups, which called it a politically motivated use of a law intended to safeguard national security. However, many in Congress also complained that the CATIC-MAMCO transaction was used by the Bush administration in a cynical way to diffuse pressures to "get tough" with China and that baring one Chinese investment in the United States hardly represented an adequate response to the Tiananmen Square massacre.

Indeed, many of the severest congressional critics of the Bush administration's interpretation of the Exon-Florio amendment were not impressed by the CATIC-MAMCO episode. While Senator Exon, a moderate on the issue of inward foreign direct investment, welcomed the administration's action on CATIC-MAMCO by saying, "I am convinced that this action will send a very clear signal to all foreign buyers that the Exon-Florio law is meaningful," others were not as generous.[43] Many were incensed that the president chose to act on a case involving such a low-technology company to demonstrate that the administration had the will to use the authority given to the president by Congress. They felt that CFIUS mechanism was intended as a response to the high-technology challenge from foreign competitors, especially Japan, and if this mission was not clear, then, the law needed to be enhanced or be clarified.[44] Indeed, the General

---

[43]Rosenthal, *op. cit.*

[44]They were also annoyed by the accompanying administration statement by Marlin Fitzwater, the White House spokesman, that "[the ban] does not change our open investment policy, and is

Accounting Office (GAO), a congressional "watchdog" agency, warned Congress that the White House has defined the scope of CFIUS investigations extremely narrowly in terms of direct military impact.

Nevertheless, if an even-handed review of CFIUS's activities were conducted, it would confirm that the Exon-Florio amendment created a checklist of factors that the president had to consider in reviewing the national security impact of prospective foreign investments. The consequence of this was that it created an institutionalized, *de facto* screening mechanism with flexibility and "teeth" that critics in Congress and elsewhere refused to acknowledge and the administration did not want to admit for the fear of alarming or discouraging foreign investment.

<u>The Huels-Monsanto Case</u>

Despite the criticism from some that CFIUS almost never objects to most actionable transactions under the Exon-Florio amendment, CFIUS had on a number of occasions changed the terms of the investment to the advantage of U.S. national interest, hence avoiding any overt policy action. The examples include the very first CFIUS investigation under the Exon-Florio amendment.[45]

In late 1988, CFIUS investigated the proposed takeover of the silicon wafer division of the Monsanto Company, an American firm, by Huels A.G.,

---

not a precedent for the future with regard to direct investment in the United States from the People's Republic of china or any other country." *Ibid.*

[45]There are other cases-- Japan's Tokuyama Soda's bid for General Ceramics and Japan's Toho Titanium's bid for Titanium Metals Corporation of America (TIMET)-- where the presence of CFIUS resulted in restructuring of the deal. In the acquisition of General Ceramics, Tokuyama Soda agreed to place General Ceramics' existing classified work for the Energy Department in a U.S.-owned holding company. In the TIMET's case, Toho Titanium agreed not to transfer TIMET's technology to Japan if CFIUS did not formally investigate the case. See Spencer, *op. cit.*, p. 9.

a subsidiary of the German firm VEBA A.G. The division, Monsanto Electronic Materials Co., was the last remaining U.S. producer of silicon wafers for the commercial semiconductor market, apart from certain captive operations of vertically integrated U.S. firms.[46] In this transaction, CFIUS, at the initiative of the Defense Department, sought to assure that Sematech, the U.S. semiconductor research and development consortium supported in large part by Defense Department funding, would have ready access to Monsanto's silicon products.

At first, there was some hesitation among some members of CFIUS whether to pursue the investigation called for by the Exon-Florio amendment. Supposedly, there was reluctance among some Treasury officials to enforce the newly enacted law in this case because a CFIUS intervention on behalf of Sematech would have "smacked of industrial policy." However, other members of the committee felt that the transaction should be prohibited to preserve independent U.S. production of Monsanto Electronic Materials' products. When the Treasury Department's reluctance was disclosed by the Bureau of National Affairs' "Daily Report for Executives," the uproar in Congress was such that Treasury Secretary Nicholas Brady had to send letters to both Senator Exon and Representative Florio assuring them that the department would carry out the law.[47]

In the end, CFIUS "persuaded" Huels officials to provide written assurances to Secretary Brady that the production of the silicon wafers would

---

[46]The sale of Monsanto Electronics Materials Co. came on top of recent sales of other U.S. silicon and wafer fabrication firms, and the Monsanto sale reduced U.S. companies' share in the world market from 45 to 8 percent. *Ibid.*, p. 15.

[47]Letters dated December 19, 1988, cited by Martin and Susan J. Tolchin, *Selling Our Security: The Erosion of America's Assets* (New York: Alfred A. Knopf, 1992), p. 53.

be maintained in the United States. Huels officials also pledged that the acquired division's research and development would be conducted in the United States and its technology would not be transferred for five years and that silicon wafers would be made accessible to the U.S. semiconductor industry.[48] As a result of the assurance given by the transacting parties, CFIUS unanimously recommended that the transaction should be allowed to proceed, and President Bush concurred with that decision on February 3, 1989.[49]

The Fanuc-Moore Case

If the executive branch was reluctant to act formally toward a controversial transaction, through the "tripwire" mechanism which was in effect established by Exon-Florio's empowerment of CFIUS, Congress could bring its powers to bear directly on the matter. Indeed, there were several instances where the White House reluctance to act on a transaction investigated by CFIUS brought about the direct intervention of Congress. One particular case involved the agreement by Fanuc Ltd., a giant Japanese machine tool manufacture, to acquire a minority equity stake in privately-held Moore Special Tool Company of Bridgeport, Connecticut.

The transaction came to the attention of Congress when John Niehuss, the Treasury Department's senior deputy assistant secretary for international

---

[48]Testimony by Bradley Larschan before the House Committee on Energy and Commerce, U.S. Congress, February 26, 1991, p.8.

[49]Nonetheless, many in Congress were not pleased with the quick approval of the transaction by the administration. Led by Representative Florio, almost thirty members of the House signed a letter to the president protesting the decision and urging him to block the transaction on national security grounds considering that CFIUS had no formal authority to enforce the *quid pro quo* it engineered. See Tolchin, *op. cit.*, p. 54.

economic policy, told a Senate science subcommittee that CFIUS was looking into the agreement between Fanuc and Moore.[50] Moore was involved in nuclear-weapons work; it was the only U.S. firm that made precision machine tools that met the special requirements of the Defense and Energy departments for making nuclear weapons.[51]

Fanuc proposed to acquire 40 percent of Moore. Fanuc's investment, which would have given two seats on Moore's five-member board to the Japanese firm, was described as passive in nature, and Moore and Fanuc had agreed to strict rules about what information and technologies were to be shared. Moore was losing money in recent years and had difficult time attracting bank financing.[52] Moore sought Fanuc's investment to carry out a long-term plan to modernize its plant and manufacturing processes while

[50]Niehuss was testifying before a Senate panel chaired by Albert Gore Jr. of Tennessee. Gore had called the hearing to criticize the Bush administration for doing a "lackadaisical" job of screening foreign takeover of U.S. high-technology assets. Gore was especially concerned about the granting of clearance to Nippon Sanso K.K.'s offer to purchase Semi-Gas Systems Inc., the leading U.S. producer of high-purity industrial gas systems, from Hercules Inc. Gore and others were afraid that the approval would undermine the U.S. effort to help the domestic semiconductor industry to become more competitive. See Eduardo Lachica, "Foreign Stakes In U.S. Technology Are Under Review," *Wall Street Journal*, October 11, 1990.

[51]Moore's products included computer-operated jig borers that gouge tiny, highly accurate holes in metal, and other precision machining equipment. Machines made for making certain parts for nuclear weapons represented less than 10 percent of its overall business. Beyond their use in the manufacture of nuclear weaponry, the company's products were widely employed in the manufacture of watches, cameras and other precision products. Moore exported more than 60 percent of its output; and because of their strategic importance, many of its products were subject to rigorous government export licensing requirements. See Lachica, "Japan's Fanuc Ends Bid to Buy 40% Of Firm Doing Sensitive U.S. Job," *Wall Street Journal*, February 20, 1991. Also, Clyde H. Farnsworth, "Japanese Drop a U.S. Investment: Fanuc Nuclear Tie Had Upset Congress," *New York Times*, February 19, 1991.

[52]The blocking or delay of Moore's major overseas contracts by the federal government was said to be one reason for the company's financial troubles. Also, in recent years, one of Moore's prime sources of financing was the troubled Bank of New England, which the federal government seized as being insolvent. See Farnsworth, "U.S. Clears Japanese Stake In Atomic-Arms Toolmaker," *New York Times*, January 18, 1991.

Fanuc sought Moore's technologies and processes to round out its product line.[53]

Given the sensitive nature of its products, Moore's sale of its shares triggered a CFIUS investigation in October 1990. The Defense, and Energy departments wanted to bar the investment, concerned that sensitive security information could pass to a foreign firm while the Commerce Department was anxious that another small American high-technology firm was falling into the orbit of a well-financed Japanese giant. However, the State and Treasury departments argued that, if the transaction was barred, Moore could go bankrupt and the United States would lose Moore's technologies and products entirely.[54]

Given that the proposed deal was not an outright takeover, the State and Treasury departments' argument prevailed in the CFIUS debate. Also, CFIUS was persuaded that no similar technology could be purchased abroad; hence, a part of the decision came down to a choice of "either save the company or lose the technology."[55] In late December, CFIUS recommended the approval of the deal to the president.

The White House appeared to be leaning toward accepting the CFIUS's recommendation before it was besieged by congressional protest. The CFIUS recommendation angered many in Congress. The congressional reaction was

---

[53]Fanuc and Moore would have made a good match because the combination would have enhanced both concern's competitive positions, according to industry analysts. Fanuc made numerical controls for programming machine tools while Moore produced state-of-the-art jig grinders and measuring machines. See Lachica, *op. cit.*

[54]Indeed, Moore argued that unless it obtains an infusion of cash, its ability to continue contributing to U.S. defense needs could be in jeopardy. Moore's attorneys said Fanuc's offer of 10 million dollars for a minority stake was the best alternative among several financial options the firm had entertained. *Ibid.*

[55]Farnsworth, *op. cit.*

particularly harsh because the Fanuc-Moore transaction followed another controversial decision made by CFIUS concerning Nippon Sanso K.K.'s purchase of Semi-Gas Division of Hercules Inc.[56] Upon hearing the decision of CFIUS, the sponsors of the Exon-Florio amendment in the House Energy and Commerce Committee scheduled a special hearing on the Fanuc-Moore matter.[57] Congress was about to exercise its *ex post* power to judge the use of delegated power.

The recommendation drew a storm of criticism from Congress which, at the time the transaction was being reviewed, was considering the extension of the lapsed Exon-Florio amendment.[58] The Representative Mel Levin, a Democrat from California and the chairman of the House High Technology Caucus, protested that "failure to stop this sale sends a clear signal that everything, no matter how vital to our interests, is for sale in the U.S."[59] He proposed that Congress should seek legislation to create a loan guarantee fund to help keep financially ailing companies such as Moore afloat while

---

[56]The earlier decision involved the purchase of the Semi-Gas Systems division of Hercules, a U.S.-controlled chemicals producer, by the Japanese firm Nippon Sanso. Semi-Gas Systems produced ultra pure industrial gases employed in the making of high-performance semiconductor microchips. What made the decision so controversial was that Semi-Gas was a supplier to the government financed Sematech semiconductor consortium and was active in Sematech's research and development activities. The White House cleared this transaction after receiving assurances that the new owners would restrict the dissemination of technical data that Semi-Gas had accumulated in activities with Sematech. However, the congressional reaction was such that it directed the Justice Department to launch an antitrust suit against the transaction. (Upon a favorable CFIUS finding, in September 1990, Senators Jeff Bingaman, a Democrat from New Mexico, and Lloyd Bentsen, a Democrat from Texas, demanded an investigation of the transaction on antitrust grounds and, as a result, the Justice Department filed suit to prevent the acquisition.)

[57]Lachica, *op. cit.*

[58]The Exon-Florio amendment, although enacted as part of the 1988 trade act, was technically an amendment to the Defense Production Act (DPA), an impermanent statute requiring periodic reauthorization by Congress.

[59]Farnsworth, *op. cit.*

they search for "appropriate American buyers."[60] Even some Republicans, particularly nationalistic ones such as Representative Helen Bentley of Maryland, demanded that the White House block the purchase.[61] In January 1991, ten members of Congress wrote President Bush demanding that the transaction be banned.

When it became apparent that Congress was not going to accept the official CFIUS finding, the transacting parties decided to renegotiate the terms of the deal in order to make it more politically palatable. The Fanuc-Moore deal was originally structured so that within five years either the Japanese firm or the Moore family, which controlled the American company, could buy out the other party. This was a major cause of the congressional concern that Fanuc could end up in undisputed control.[62] Hence, in order to ease the congressional worry, the terms were changed so that the new agreement left the Moore family with the right to buy out Fanuc but no reciprocal right for the Japanese firm.[63]

However, it soon became evident from the fury of congressional activities that the transaction was becoming a lightening rod of congressional discontent toward the Bush administration's interpretation of the Exon-Florio amendment. Pressured by the critics in the United States as well as

---

[60]Lachica, *op. cit.*

[61]*Ibid.*

[62]Farnsworth, *op. cit.*

[63]Of course, even under the revised agreement, should Moore continue to lose money over the next two years, Fanuc would take effective control of the company by naming a third director though Fanuc gave assurance that one of its two initial directors will be American, and if it is entitled to name a third director that person would also be an American. However, Fanuc's control of the board would end if Moore turned a profit, when the third board seat would be given up. *Ibid.*

those in Japan who felt Fanuc was attracting unwanted ire against Japanese direct investment in the United States, Fanuc withdrew its offer to buy a stake in Moore. In its decision to drop the deal, Fanuc cited "review procedure's indefinite duration and burdensome nature to all concerned" in addition to the negative reaction in Congress.[64]

Indeed, Fanuc released a statement which left little doubt that the lawmakers' reaction figured heavily in its decision. The Japanese firm complained that the policymakers in Congress had "seized upon this proposed investment as a vehicle for expressing their larger concerns."[65]

Beyond Exon-Florio

Obviously, much policy differences remained between congressional policymakers and the president even after the Exon-Florio amendment was passed into law. While a new policy equilibrium was reached with the amendment's passage where the regulation targeting incoming direct investments could not be readily ratcheted up or down, the policymakers continued to clash over the procedural and definitional issues surrounding the routine operation of the regulatory apparatus targeting these investments.

Because of the leeway that had to be given to the president in carrying out the mandate of the Exon-Florio amendment in order to pass the law in the first place, the White House, under Republican control, was able to interpret the law so narrowly that CFIUS was not able to approach prospective

---

[64]Farnsworth, "Japanese Drop a U.S. Investment: Fanuc Nuclear Tie Had Upset Congress."

[65]*Ibid.*

inward direct investments in a comprehensive manner that many in Congress felt was intended by the legislation's operative language. While it was too costly for those disaffected with the White House interpretation of the Exon-Florio amendment to rewrite the law completely, this "interpretive gap" was something the policymakers in Congress could address with their oversight functions.

Indeed, in their quest to tighten the gap, the often favored tactic of the policymakers in Congress was to make, or attempt to make, procedural changes in the existing regulatory mechanism.[66] For example, charging that the White House was ignoring the Exon-Florio mandate, Representative Douglas Walgren, a Democrat from Pennsylvania who had replaced Florio as the chairman of the Subcommittee on Commerce, Consumer Protection and Competitiveness, introduced a new legislation, H.R. 5225, to beef up the Exon-Florio mechanism with the help of the House Majority Leader Richard Gephardt, a Democrat from Missouri with presidential ambition.[67] The bill would have strengthened the Exon-Florio provision by explicitly defining the operative term "national security" in the provision to include anything that might injure the industrial and technological base as a threat to security.

With the electoral defeat of Walgren in the 1990, the bill was reintroduced as H.R. 2624, the Technology Preservation Act of 1991, by the new chair of the subcommittee, Representative Cardiss Collins, a Democrat from Illinois, with-- once again-- the co-sponsorship of Richard Gephardt.

---

[66]The issues related to the administration's implementation of the Exon-Florio amendment were raised in the context of the congressional debate over the lapse of statutory authority for the Exon-Florio provision and its subsequent reauthorization, as well as the larger debate over the reauthorization of the DPA. As mentioned earlier, the DPA contained a "sunset" provision that also applied to the Exon-Florio amendment. See Section 717 (a) of the DPA.

[67]H.R. 5225, Second Session, 101st Congress.

The new bill called for the following: First, remove the director of OMB and the chairman of the Council of Economic Advisors (CEA) from CFIUS while adding the secretary of energy, the national security advisor, and the head of the Office of Science and Technology Policy. Second, establish a formalized review and investigative process through which policymakers in Congress could participate in the reviewing of inward foreign direct investment. Third, change the credible evidence standards of the Exon-Florio mechanism to allow for a more subjective presidential finding while shifting the burden of proof to the foreign investor. Fourth, have the Defense and Commerce departments be in charge of the collection and flow of data to CFIUS, rather than the current chair of CFIUS, the Treasury Department. Fifth, have CFIUS review all transactions involving technologies designated as "critical" by the Commerce and Defense departments. And sixth, require that, if such a "critical" technology is involved in a transaction, have the Commerce and Defense departments obtain certain performance requirements from the foreign party and publish these requirements in the *Federal Register*.[68]

While even many supporters of the bill acknowledged the potential problems with some of the proposals, the bill-- along with a number of other proposals-- reflected the dissatisfaction of Congress, particularly the Democratic membership, with the White House handling of the inward direct investment issue as the 1992 presidential election got under way. And among the many complaints against the regulatory system, there was a clear discontent with the Treasury Department's chairing of CFIUS. Many in Congress believed that the treasury secretary's appointment as the chair of CFIUS had unavoidably tilted the panel away from the rigorous and

---

[68]H.R. 2624.

comprehensive enforcement of the Exon-Florio mandate. They felt that Treasury lacked the expertise to judge the impact of foreign investment on the economy, either from a national security point of view or in terms of investment's impact on specific sectors and industries.[69]

Furthermore, they felt that with the addition of the OMB to the membership of CFIUS, the White House had "stacked the deck." Hence, there was great desire among those who wanted CFIUS to be more "pro-active" to rid the committee of some of the ample presidential representatives and add other agencies, such as the Energy Department, which were more predisposed to interpret the Exon-Florio mandate more aggressively.

The White House did what it could to hold back the attempts by those activists in Congress to change the terms of the compromise creating the Exon-Florio mechanism. In the case of the Collins-Gephardt bill, Treasury Secretary Nicholas Brady reiterated the perennial White House argument in a letter to House Energy and Commerce Committee Chairman John Dingell, a Democrat from Michigan, that congressional activism on the issue would raise barriers to investment and undermine the U.S. policy of liberalizing foreign investment regimes. For a good measure, Secretary Brady warned

---

[69]The Treasury's prime interest, after all, had been attracting foreign capital to finance the U.S. deficit. In a congressional testimony, a Treasury official stated that it was his understanding that Exon-Florio presumes that foreign investment benefits the U.S. economy and becomes suspect only if there is credible evidence that the investor will act in a way detrimental to our national security. Testimony by John Niehuss, a senior deputy assistant secretary of the Treasury Department, before the Senate Commerce Subcommittee on Science, Technology and Space (October 10, 1990), as reported in *Foreign Investment in the United States News and Analysis*, November 1990.

that if Congress approved the bill as then drafted, the president would veto the bill.[70]

As earlier in the 1970s, the White House tended to be more cooperative in congressional efforts to gain better data on the nature and extent of inward investment. While the Reagan administration generally resisted congressional proposals for obtaining additional information on direct investment, the Bush administration supported better data in anticipation of more extensive legislations. It supported the Foreign Direct Investment and International Data Improvement Act of 1990 which further strengthened the government information-gathering process, authorizing interagency sharing of data.[71] The act, passed with bipartisan support, provided for the exchange of foreign investment data already compiled by the Department of Commerce's Bureau of Economic Analysis (BEA) and the Bureau of the Census, and required the secretary of commerce to prepare annual reports to Congress on foreign direct investment.[72] It also gave the GAO access to confidential foreign investment data for the purpose of preparing reports, and allowed BEA to make data available to CFIUS subject to strict confidentiality.

---

[70] Letter dated November 15, 1991.

[71] Public Law 101-533, Second Session, 101st Congress, November 7, 1990.

[72] Two agencies in the Commerce Department collect the most comprehensive data, but figures from these two sources are not comparable. The Bureau of Economic Analysis (BEA) surveys foreign investment under the auspices of the International Investment and Trade in Services Act. The International Trade Administration (ITA) collects its data indirectly from public sources, including the media. Other federal agencies collect information on foreign investment within their specialties. Among these are the Federal Reserve System, the Department of Agriculture, the Securities and Exchange Commission, and several other federal regulatory agencies. For BEA data, see *Survey of Current Business*. The main ITA data source is *Foreign Direct Investment in the United States, 19-- Transactions* (Washington, D.C.: Department of Commerce, International Trade Administration, Office of Trade and Investment Analysis, published annually).

However, with other measures not to its liking, the White House mobilized whatever support it could muster in and out of government to resist congressional pressures. In Congress, it relied on administration loyalists and international-minded members of Congress.[73] It also relied on industry associations, particularly those with broad-based or large transnational corporate membership such as the National Association of Manufacturers and the U.S. Council for International Business, to remind activists legislators that regulating foreign direct investment, if pushed too far, was a dangerous two-edged sword. And, on the whole, the White House was successful in fending off many legislative attempts to undo the compromise, particularly on purely technical merits, given the extraordinary difficult task of writing laws that favored the United States but, at the same time, would not invite some sort of retaliatory response from abroad.

Nonetheless, the White House could do very little to prevent Congress's direct involvement in proposed foreign takeovers, such as the Nippon Sanso-Semi Gas case and the Fanuc-Moore case. Indeed, through these "investigatory" interventions, Congress made its strongest case for a tougher policy toward inward foreign direct investment.[74] The situation was

---

[73]For example, the White House was helped by moderates such as Senator Exon who felt that the provision he co-authored should be left alone.

[74]Another example is the call from the Senate in the fall of 1991 for an Exon-Florio investigation of the proposed sale of a 40 percent interest in the commercial aircraft division of the McDonnell Douglas Corporation to the Taiwan Aerospace Corporation, a company owned in part by the Taiwanese Government. Soon after the proposed Taiwan Aerospace deal was announced, thirty Senators, including Senate Majority Leader George Mitchell, a Democrat from Maine, sent a letter to President Bush on November 18 urging an investigation by CFIUS into the transaction. Among other things, the Senators feared that the proposed sale would cause the transfer of a tremendous amount of aerospace technology to Taiwan. Subsequently, Senator Jeff Bingaman, who drafted the Senate letter, introduced a resolution (S. Res. 234) calling for presidential action to prevent the proposed sale. Senator Bingaman's resolution, cosponsored by 14 other Senators, requests a 60-day investigation into the transaction, including an examination of the potential long-term impact of the deal on the supplier base of the U.S.

such that, on December 26, 1991-- following the passage of the Senate Resolution 234 calling for a broader review of the Taiwan Aerospace Corporation's attempt to buy 40 percent of McDonnell Douglas Corporation's commercial aircraft division-- the White House felt it necessary to issue a new presidential policy statement on international investment, again committing the United States to a policy supportive of "non-discriminatory treatment" of foreign investment.[75]

Still, these incidents of Congress's very public display of its displeasure toward the executive handling of the inward foreign direct investment issue made the White House take a much more activist approach toward regulating inward foreign direct investment in the United States than it would otherwise have on its own. Indeed, the White House could not ignore congressional displeasure given that it is Congress that writes the laws. While there was a great incentive to prevent or minimize political damage from the partisan grandstanding on the issue, there was a clear political imperative to forestall more serious efforts by Congress to pass restrictive laws and bound the president's hands in foreign economic policy matters.

Summary

In the 1980s, with the massive inflow of Japanese direct investment into the United States and the rise of new politics of economic

aerospace industry. Indeed, the widespread publicity concerning the Taiwan Aerospace-McDonnell Douglas acquisition greatly heightened congressional awareness of the Exon-Florio amendment and its potential uses. Personal interview with a member of the Senate.

[75]"United States Foreign Direct Investment Policy," The White House, Office of the Press Secretary, December 26, 1991.

competitiveness, policymakers in the White House and Congress strengthened the regulatory mechanism targeting inward direct investments. Building around the interagency committee, CFIUS, these policymakers created a new regulatory apparatus capable of screening and reviewing virtually all inward foreign direct investment in any sector of the economy deemed vital to a new notion of national security: "economic security." Indeed, with the passage of the Exon-Florio amendment, the review process for inward direct investment in the United States became, for the first time in history, formalized and legitimized by law. CFIUS, hastily patched together by the Ford administration during the 1970s and reshaped by the Reagan and Bush administrations in the 1980s, now operates under a formal body of rules overseen by a vigilant Congress wary of foreign competition and sensitive to voter concerns about the future of the U.S. economy. Although the Republican-dominated White House of the 1980s was a reluctant and conservative partner, it nonetheless was a party to Congress's policy-strengthening effort spurred on by national anxiety about America's economic future.

CHAPTER TWELVE

Summary and Some Speculations

Inward foreign direct investment in the United States has generated political controversy throughout U.S. history. As suggested earlier, it may be that foreign investment was not a policy concern only during the first decade and a half following World War II when no significant amount of investments were coming into the country and the containment of international communism was the overriding foreign policy objective of the United States. Otherwise, throughout U.S. history, foreigners buying U.S. assets has generated varying degrees of public apprehension and regulatory ambivalence given the fact that direct investment constitutes a more immediate, tangible form of foreign influence in the host economy. The experience of the past two decades proved no exception.

Policy Dynamics

After a period of dormancy, the inward direct investment reemerged as a subject of policy concern in the United States in the last two decades when dramatically increased levels of incoming investment coincided with various economic crises and adjustment problems associated with the globalization of markets and the decline of U.S. economic competitiveness. The elected policymakers in Congress and the White House, spurred on by voter anxiety, revisited and revised the U.S. policy toward inward foreign direct investment on a number of occasions since the mid 1970s.

Indeed, during the last twenty years, the president and members of Congress were the principal drivers of these policy revisions. Of course, these politicians tended to view incoming investments favorably to the extent that they felt that the inflow resulted in net benefit to their constituents and their own political goals and interests.[1] However, to the extent that they perceived such investments endangering the national autonomy and economic competitiveness of the United States and their concern about them contributing to their own political good fortune, they attempted to regulate these investments in some way.

In this calculation, public opinion and perception played a vital role. While it is true that much of the actual regulatory questions concerning the direct investment issue were esoteric and ambiguous, the apparent flood of foreign direct investments-- as it aroused apprehension about the economic security of the country, suspicions about the motives of OPEC investors, and resentment toward Japanese economic successes-- was something that many voters were worried about. This public anxiety, though often irrational, was something that many lawmakers in Congress could not resist exploiting for political gains and the president simply could not ignore.

[1] Indeed, despite much political grandstanding, there was never any serious effort in Congress to radically alter the welcoming policy toward incoming direct investment. The policy struggle between the White House and Congress was about on what terms and how can the positive effects (both in terms of economic and political) of inward foreign direct investment be maximized within the liberal framework while minimizing the negative effects.

While public opinion and perceptions greatly influenced the identification of the inward foreign direct investment issue as a matter of policy concern in the eyes of elected policymakers, as already discussed, organized interest groups did not have much of an impact on specific policy outcomes. Certainly, the constellation of interests benefiting from the liberal investment climate in the United States made it unlikely that any measure that would seriously jeopardize that climate would ever be passed into law by Congress and approved by the president. However, these interests played only an ancillary role in the policy struggle leading to the buildup of the screening apparatus centered on CFIUS which, while not altering the general liberal investment environment in the United States, has fundamentally changed the way in which direct investments are regulated by the federal government.

As for the role played by the "state bureaucracy," it is not clear that even some of the modest policy measures targeting inward foreign direct investment would have been undertaken by the Treasury Department or other executive agencies on their own initiative without firm directions from elected officials in the White House and Congress. Indeed, in this policy arena, the administrative agencies tended to play a passive role and were often subject to manipulation by elected leaders who created new procedures and hierarchies among executive agencies to serve their own policy objectives and political goals.

Of course, these politicians were often at odds on the specifics of policy action toward inward investment because of, among other things, the conflicting political objectives of the presidency and the legislature. While the president, as the guardian of the postwar international economic order and the only nationally elected policymaker, was careful not to allow proposals endangering the overall openness of the U.S. inward foreign direct investment policy to become law, those in Congress were more inclined to pursue a nationalistic policy approach toward inward foreign direct investment.

This is not to argue that Congress was more determined to place restrictions on inward direct investment than the White House. As argued earlier, many in Congress welcomed job-creating foreign investments in their districts. However, to the extent that opposing investments that appear to threaten the security and economic competitiveness of the country promised some electoral advantage, the policy activists in Congress were eager to "grandstand" and, if the situation warranted policy action, delegate new authority to the executive branch-- whether the president wanted it or not-- to regulate investments.

The policy adjustments that resulted were then a compromise between the contending political priorities of the president and the policy entrepreneurs in Congress. While it is true that most radical policy measures proposed by some in Congress never materialized, it was not the case that, as many neostatists would argue, the "national interest guarded by the executive elites of the state bureaucracy" prevailed over the "special interests gathered in the legislature." Rather, without great expenditure of political capital, these provocative congressional proposals served to prod the reluctant White House into pursing more aggressive policy actions it might not have considered on its own and gained some useful publicity for those proposing them. In addition, by pushing for procedural changes (creating CFIUS in the first place and latter strengthening its powers), the activist policymakers in Congress were able to obtain some degree of cooperation from the White House in carrying out their political goals without engaging the president and others opposed to their stated policy views in a more costly substantive policy battle.

Of course, the president enjoyed some political advantages in the fact that those in Congress delegated regulatory responsibilities to the executive branch. This meant that the White House enjoyed a great deal of discretion and control in executing policy. However, the policymakers in Congress were fully aware of the president's strong incentive to maintain control over executive institutions and the "discounting" of congressional intent that takes place as a result of this incentive (among many other reasons). Consequently, while no radical policy departure was made, the U.S. policy toward inward foreign direct investment in recent years has shifted from one of benign neglect to one of discretionary restriction in certain sectors of the economy.

What tends to obscure the impact that this struggle between the president and the activist policymakers in Congress had on the policy dynamics is the fact that, often, the president went forward unilaterally to adopt policy measures proposed by those in Congress-- especially the moderate measures that could derail the more radical ones. That is, instead of waiting for a congressional mandate, the White House often chose to implement what it considered the more palatable measures by an executive fiat in order to maximize the influence and control of the president in foreign economic policy matters.

As discussed in Chapter Eleven, the creation and the institutional evolution of CFIUS clearly illustrate the politics of structural choice underlying the dynamics of U.S. inward foreign direct investment policy. It should be kept in mind that CFIUS was created during the Ford administration as a policy compromise between presidential priorities and congressional concerns. In that compromise, the White House retained presidential control over the general direction of the U.S. inward foreign direct investment policy by creating an interagency committee within the executive branch reporting directly to the White House. However, the creation of CFIUS-- something that the president resisted initially-- was a White House concession to the policy activists in Congress and a commitment that the foreign direct investment issue would receive more political attention from the White House and remain subject to congressional scrutiny. Indeed, in CFIUS, those in Congress obtained, in effect, a warning mechanism within the executive branch of the government that could act as a kind of lightening rod for complaints from their supporters (and *potential* supporters) concerning the adequacy of the U.S. inward foreign direct investment policy.

CFIUS's role was limited to monitoring functions in the early years partly because the fear aroused by OPEC investments had quickly died down, but when Japanese direct investments began flooding the country during the 1980s, CFIUS became a major target of criticisms from those concerned about this new surge investments and the larger factors driving it. Indeed, CFIUS served its function as the "alarm" that refocused policymakers' attention to the investment issue. Given that there was widespread public fears about America's unprecedented trade deficits and the decline of U.S. industrial productivity *vis-à-vis* international competitors (namely, Japan), the policymakers in Congress, with White House complicity, linked the issue of foreign direct investment in the United States to the question of economic competitiveness, and CFIUS became the convenient focal point of the renewed policy struggle between the White House and Congress during the late 1980s. Through their interaction, CFIUS was strengthened and became the core of a new regulatory apparatus for pursuing a more flexible, discretionary policy toward inward foreign direct investment.

In other words, in empowering CFIUS, policymakers in Congress and the White House, though often at odds, created a new kind of regulatory mechanism capable of screening and reviewing inward foreign direct investments in any domestic industry deemed vital to a new notion of national security: "economic security." Reshaped during the Reagan and Bush administrations, CFIUS was empowered by vigilant policymakers wary of foreign competition and sensitive to voter concerns about the future of the U.S. economy.

In terms of the main substantive policy outcome of this dynamics, with the passage of the Exon-Florio amendment strengthening CFIUS, the review procedure for foreign direct investment coming into the United States became formalized and legitimized by law. In effect, a screening mechanism that has the potential power to review-- and, by extension, set performance requirements on-- virtually all inward foreign direct investments in any sector of the economy had been created.

The Explanation and the Study of Foreign Economic Policy

The key questions this study sought to answer were these: First, what accounts for the shift in the U.S. policy toward inward foreign direct investment from that of benign neglect to that of discretionary restrictions in certain sensitive sectors of the domestic economy in recent years? And second, why has this policy shift taken the shape that it has? That is, what accounts for the creation of CFIUS as the central instrumentality of U.S.

inward foreign direct investment policy? As argued earlier, although these two questions appear separable and analytically distinct, they are in fact intimately linked to one another.

There is no doubt that the changes in the larger international system affected the shifting parameters of the U.S. policy toward inward foreign direct investment. Indeed, the changing global landscape provides the necessary context for understanding the policy predicament of nation-states. However, the details of the policy history toward inward foreign direct investment in the United States demonstrate that the more immediate and compelling reasons for the shifting policy parameters are to be found lodged somewhere at the intersection of international systemic forces and the working of domestic politics.

While systemic forces must be clearly understood, it is the nature of the domestic political process that gives specific shape to the national policy response to the changing global environment. Indeed, the central feature of the recent U.S. policy activism toward inward foreign direct investment was the interplay of two complexly interlinked factors: One was the appreciation among elected policymakers that economic security is a crucial element of national security; and the other was the policymakers' perception that this "new" security issue had electoral implications.

Hence, to decipher the dynamics of the U.S. inward foreign direct investment policy in recent years, this study employed a metatheoretical analytical approach combining different levels of analysis and several theoretical perspectives. However, it placed a special burden on the analytical assumption that, driven by electoral imperatives-- yet mindful of the incentives and constraints of the international system-- it is the elected politicians who make critical foreign economic policy choices in advanced industrial democracies.

As Peter Cowhey points out, these elected policymakers, as those who hold ultimate political power in a democratic polity, determine the amount and types of discretion granted to foreign economic affairs bureaucracies in a manner consistent with their respective political calculations and anticipated problems of overseeing delegated powers.[2] Indeed, the workings of CFIUS described in this study support the argument that the foreign policy apparatus arises out of politics, and its design reflects the values, interests, and strategies of those who exercise ultimate political power in a democracy.[3]

The metatheoretical approach employed by the study captures a critical dimension of the politics of U.S. inward foreign direct investment policy which would be missed by existing approaches to understanding foreign economic policymaking in advanced industrial democracies: The approach links the calculations of elected policymakers caught between the historical U.S. commitment to the goal of liberal world economy and the new compelling demands of the emergent politics of economic competitiveness as the relative economic might of the United States in the world diminishes and domestic interests realign themselves as the result of fundamental changes taking place in the increasingly interdependent global economy.

In fact, the survey of the literature on foreign economic policymaking revealed that, despite a plethora of analytical approaches available to students of foreign economic policy, the discipline's "tool kit" lacks the appropriate instruments needed to analyze the *politics* of foreign economic policy

---

[2]Cowhey, "'States' and 'Politics' in American Foreign Economic Policy," p. 232.

[3]*Ibid.*

formulation in advanced industrial democracies such as the United States. For example, an acceptable explanation of the dynamics of inward foreign direct investment policymaking in the United States must be able to account for the policy leadership of Congress, the "hotbed of petty societal politics," in this policy arena and answer why the CFIUS mechanism was chosen and utilized as the key institution of the regulatory apparatus overseeing inward foreign direct investment.

Indeed, it was the policymakers in Congress who took the initiative in charting a new course for policy in this issue arena in recent years and have, with grudging and conditional cooperation from the White House, patched together the present regulatory framework. The existing analytical approaches, however, generally do not treat Congress as a policy*making* institution, irrespective of the issues concerning the "coherence" or "rationality" of congressional policy goals.[4] They certainly cannot account for the motive(s) behind this congressional activism. Nor can they explain, despite its skepticism and reluctance, White House complicity to the extent that it went along with Congress in order to preserve its political control over the machinery of policy implementation. The existing approaches have no explanation for the basic political considerations that explain why the various elected policymakers have defined and responded to the recent upsurge of foreign direct investment as they have.

Though the study was generally doubtful of the usefulness of the neostatist approach in analyzing the dynamics of U.S. inward foreign direct investment policy, it found helpful the neostatist observation that state elites

---

[4]As already discussed, while the interbranch branch approach may be an exception, the findings of this approach are not easily generalizable to other political systems.

can act independently of societal interests. This insight was helpful in zeroing in on the fact that, in the making of U.S. inward foreign direct investment policy, elected politicians often acted like the "statesmen" of the neostatist textbook in incorporating international imperatives into their political calculus which was not always antithetical to the "national interest." Otherwise, neostatist insights were of limited help in illuminating the vital fact that the regulatory apparatus targeting inward foreign direct investment has been largely shaped by elected policymakers (as compared to "state" or "executive" officials) to serve their political interests, not just policy goals.

What is clear in all this is that, in the study of foreign economic policymaking in advanced industrial nations, there is a need to redirect the research priority back to some of the earlier efforts to understand the basic politics that drive policy decisions.[5] For example, a more concerted effort must be made to incorporate the society-centered approach's attempt to study the interplay of political forces with the more recent neostatist focus on institutions of government. Of course, there have been some problems with certain aspects of the society-centered research, especially with regard to some of the earlier interest group studies as well pointed out by many neostatist studies of the past decade or so. Nonetheless, the earlier research was at least asking questions about the *political process.*

---

[5]The point here is not that structural choice approach should replace all others in the study of foreign economic policymaking in advanced industrial nations. As already argued, given the complexity of foreign economic policymaking process in advanced industrial societies, all analytical approaches have their uses and limits. The goal should be then, as John Ikenberry suggests, to draw upon the most applicable ones in various ways and bring in new approaches that hold promise in addressing the deficiencies of the existing ones. Indeed, analyzing such a complex political process as the formulation of the U.S. inward foreign direct investment policy invariably requires a multi-faceted approach incorporating a carefully chosen selection of analytical tools. See Ikenberry's introduction to his edited volume, *American Foreign Policy: Theoretical Essays.*

The society-centered approach's shortcomings are, in someways, more forgivable than the neostatist tendency to subordinate politics and politicians in favor of "state institutions" and "national interest." There is more to foreign economic policymaking in advanced industrial democracies than "statesmen" or "state institutions" reacting to international constraints and incentives. As with many other types of policymaking, foreign economic policymaking is beset by collective action problems, and elected politicians respond to such problems by designing regulatory agencies in ways which will not just meet policy goals but further their own political objectives.[6] Understanding of state institutions are important, but even more important is knowledge about institutional change within some broader conception of politics. This study has attempted to take a step, albeit a small one, toward this "new" direction.

WhitherPolicy?

Although the volume of direct investments coming into the United States has declined in recent years as economic activities around the world have slowed, foreign direct investment will, no doubt, continue to play a major role in the U.S. economy. As long as Americans consume more than they produce and do not save enough to invest in new productive capacity to close this consumption to production gap, trade deficit is inevitable as

[6]One major theme of "new institutionalism" is that the policymaking process itself shapes policy. McCubbins, Noll, and Weingast, "Structure and Process, Politics and Policy: Administrative Arrangements and Political Control of Agencies." Also McCubbins and Schwartz, "Congressional Oversight Overlooked: Police Patrol Versus Fire Alarms."

foreigners meet the excess demand of U.S. consumers and make up for the shortfall in savings. This trade deficit, of course, increases the U.S. debt held by foreigners which, in the end, must be paid off by selling assets if domestic production cannot be expanded in excess of domestic consumption.

Furthermore, direct investments in the United States have been spurred on by long-term business trends. One such trend has been the increasing number of foreign firms committed to building viable businesses in the United States. This trend will continue. The fact is that markets for many goods and services produced by advanced industrial economies are becoming increasingly global. This means that more firms than ever must rely on investments abroad to establish strategic business alliances and obtain information, technology, parts, and product variety.

These economic realities will not allow the controversy surrounding foreign direct investment in the United States to quiet down for good. Given the prospect of the resumption of direct investment activities with economic recovery abroad, the persistence of the fundamental problem of high consumption and low savings facing the United States, and the continuing competitive pressures from abroad, it is likely that the political controversy surrounding inward foreign direct investment will flare up again.

Besides, in Washington, many policymakers have become convinced that foreign economic policy alternatives are no longer limited to open markets and protectionism in the emerging "New World Order." Some of them have embraced the argument that, since many competitor nations throughout the world regulate trade and investment in ways that include embracing open markets to foreign competition and national industrial policies simultaneously, the United States must do the same.

More importantly, elected policymakers have become increasingly sensitive to the fact that intensifying international competition for markets is producing among voters much anxiety about the economic future of the country. Indeed, many Americans now believe that domestic industries are suffering in international competition not because of lack of effort or ability but because other countries are using unfair means to propel their own industries while the U.S. government does nothing. As even the most competitive domestic industries are now demanding a pro-active role for the government, politicians are more and more willing to respond to their demand not just to champion the policy agenda of a powerful interest, but to enhance their political standing with the larger electorate that is increasingly concerned about the "economic security" of the country.

Given this political atmosphere, it is not too difficult to imagine the renewal of policy activism toward inward foreign direct investment as part and parcel of the politics of economic competitiveness when the investment volume recovers. While a sudden transformation of policy from that of general openness to one of tight restriction commiserate with public xenophobia is unlikely, it is possible that the U.S. policy toward inward direct investment could become more interventionist in certain key sectors of the economy as an element of a more aggressive trade policy or some sort of "industrial policy" as the political leadership grasps for remedial measures in dealing-- or not dealing-- with the more fundamental problems ailing the United States.

Furthermore, as long as public apprehension persists about Japan's status as a financial and technological superpower sustained by its remarkable manufacturing prowess, it is likely that elected policymakers in the United States will continue to view Japanese direct investments in the United States as targets of opportunity. With many bitter ongoing commercial disputes between the United States and Japan and the security relationship between the two fundamentally transformed by the collapse of the Soviet Union, the nature of Japanese investment activities in the United States will remain suspect to many.

Though Japanese investment in the United States has slowed considerably in the past couple of years, the flow of direct investments from Japan will, no doubt, rebound as the Japanese economy makes its inevitable recovery. It is unlikely that the breakneck speed with which the Japanese have increased their holdings in the United States during the 1980s will be replicated in the 1990s, but there can be little doubt that Japanese investments will again find their way into the United States. It is also likely that the majority of these investments will take the form of mergers and acquisitions, rather than "greenfield" investments, and this will again fan the fear that the Japanese are not creating new jobs or enhancing growth in the United States but, rather, they are "hollowing out" U.S. industries and technologies.

Indeed, as some argue, the direction of the U.S. foreign economic policy may be being determined by the power structure underlaying the trans-Pacific relationship. If this is the case, it is likely that the issue of Japanese direct investment in the United States will attract even more political attention than ever before because there would be less and less reasons for policymakers in the United States to indulge what they see as the economic misdemeanors of Japan in the interest of greatly diminished security objectives while the fear of Japanese high-technology economic challenge would grow more and more in the United States.

The increasing interdependence between the United States and Japan will not mitigated these negative American feelings toward the Japanese, as least not in the short term. Misgivings about Japanese investments are precisely rooted in the fact that Japan and the United States are becoming increasingly interdependent economically. Clearly, what was once a relatively simple and limited trade rivalry between steadfast allies has now become a fierce global economic competition involving leading-edge industries of the two nations complicated by many thorny realities of interdependence of which the intensifying international investment activities of transnational corporations are but one.

Indeed, many factors point to the future revival of policy activism toward inward foreign direct investment in the United States and, more than likely, this activism will center on further beefing up the CFIUS mechanism. As the White House and Congress go about their usual business in this policy arena, it is possible that CFIUS could adopt a broader, more formal definition of national security, so that potential foreign investors, recognizing the risk of U.S. government intervention, will be forced to submit all proposed acquisitions to CFIUS for approval.

In many ways, today, the world seems to be rushing toward a borderless global economy marked by "stateless" multinationals, round-the-clock electronic financial markets, and trillions of dollars' worth of investments crossing international borders. However, those who believe that the global economy is moving toward a new age unencumbered by any form of political boundaries should keep in mind that if fears of political influence by foreign investors are indeed groundless, then politicians will be one of the last groups with solely national constituents. Indeed, the populist impulse to limit or regulate foreign direct investments will remain potent for some time to come. If the Unites States cannot fix its economic woes and come to terms with the realities of international economic competition, the world may soon see whether free trade as well as an open environment for cross-border investment can coexist for very long with specific reciprocity and greater bilateralism among nations.

APPENDIX

Note on Interviews

The interviews cited in this study were conducted from 1989 to 1993. They constitute only a fraction of the interviews conducted with government officials, business executives, specialists in international investments, lobbyists, policy analysts, and others knowledgeable about the subject of this study. They included both face-to-face and over the telephone interviews. Generally, information gathered from these sources were obtained "informally," that is from unstructured conversation with the implicit understanding that the interviewee would not be identified as a specific source of information. In those instances where a more formal interview was conducted, it was invariably with a currently serving official of the United States government and he or she was assured strict confidentiality prior to the interview.

Bibliography

Aitken, Hugh G. J., *The Continuous Wave: Technology and American Radio, 1900-1932* (Princeton: Princeton University Press, 1985).

Almond, Gabriel A., "The Return to the State," *American Political Science Review*, Vol. 82, No. 3 (September 1988), pp. 853-74.

Alt, James E., and Kenneth A. Shepsle, eds., *Perspectives on Positive Political Economy* (Cambridge: Cambridge University Press, 1990).

"American Weapons, Alien Parts," *Science*, October 10, 1986.

Amin, Samir, *Unequal Development* (London: Monthly Review Press, 1976).

Archer, Gleason L., *History of Radio* (New York: American Historical Society, 1938).

Arnold, R. Douglas, "The Local Roots of Domestic Policy," in Thomas Mann and Norman Ornstein, eds., *The New Congress* (Washington, D.C.: American Enterprise Institute, 1981).

---------, *The Logic of Congressional Action* (New Haven: Yale University Press, 1990).

Baldwin, Robert, *The Political Economy of U.S. Import Policy* (Cambridge: M.I.T. Press, 1986).

Barnet, Richard J., and Ronald E. Muller, *Global Reach* (New York: Simon & Schuster, 1974).

Bergsten, C. Fred, "The Primacy of Economics," *Foreign Policy*, No. 87 (Summer 1992), pp. 3-24.

Bhagwati, Jagdish, "The Diminished Giant Syndrome: How Declinism Drives Trade Policy," *Foreign Policy*, Vol. 72, No. 2 (Spring 1993), pp. 22-6.

Borrus, Michael, James Millstein, and John Zysman, "U.S.-Japanese Competition in the Semiconductor Industry: A Study in International Trade and Technological Development," *Policy Papers in International Affairs*, 17 (Berkeley: University of California, Institute of International Studies, 1982).

Bosworth, Stephen W., "The U.S. and Asia in 1992: A New Balance," *Asian Survey*, Vol. 33, No. 1 (January 1993), p. 103-13.

Bradsher, Keith, "U.S. Seeks To Reopen Japan Deal," *The New York Times*, January 26, 1993.

Buckley, Peter J., and Brian R. Roberts, *European Direct Investment in the U.S.A. Before World War I* (New York: St. Martin's 1982).

Burstein, Daniel, *Yen! Japan's New Financial Empire and Its Threat to America* (New York: Fawcett Columbine, 1988).

Calder, Kent E., "The Emerging Politics of the Trans-Pacific Economy," *World Policy Journal*, February 1985, pp. 593-623.

Cardoso, Fernando H., and Enzo Faletto, *Dependency and Development in Latin America* (Berkeley: University of California Press, 1979).

Caves, Richard E., *Multinational Enterprise and Economic Analysis* (Cambridge: Cambridge University Press, 1982).

Choate, Pat, *Agents of Influence* (New York: Alfred A. Knopf, 1990).

Chubb, John E., and Terry M. Moe, "Controversy: Should Market Forces Control Educational Decision Making?" *American Political Science Review* Vol. 84, 1990, pp. 558-67.

Cohen, Benjamin J., "Mixing Oil and Money," in J. C. Hurewitz, ed., *Oil, the Arab-Israel Dispute, and the Industrial World* (Boulder: Westview Press, 1976), pp. 41-56.

Cohen, Stephen S., with John Zysman, "Countertrade, Offsets, Barter and Buybacks," *California Management Review*, Vol. 28, No. 2.

Coram, T. C., "The Role of British Capital in the Development of the United States, 1600-1914," (unpublished M. Sc. thesis, University of Southampton, 1967).

Cowhey, Peter F., "Domestic institutions and the credibility of international commitments: Japan and the United States," *International Organization,* Vol. 47, No. 2 (Spring 1993), pp. 299-326.

---------, "'States' and 'Politics' in American Foreign Economic Policy" in John S. Odell and Thomas D. Willett, ed., *International Trade Policies: Gains from Exchange between Economics and Political Science* (Ann Arbor: The University of Michigan Press, 1990).

Cox, Gary W., and Mathew D. McCubbins, *Legislative Leviathan: Party Government in the House* (Berkeley: University of California Press, 1993).

---------, and Samuel Kernell, ed., *The Politics of Divided Government* (Boulder: Westview Press, 1991).

Culver, John, "Foreign Investment in the U.S.," *Foreign Policy,* Vol. 16 (Fall 1974), 157-64.

Dahl, Robert, *Who Governs?* (New Haven: Yale University Press, 1963).

Davis, Bob, "Getting Tough: Officials Who've Done Business With Japan Frame Trade Policy," *The Wall Street Journal,* June 8, 1993.

Dennin, Joseph F., "Getting Your Deal Past CFIUS: A Businessman's Guide to the Exon-Florio Review," *Foreign Investment In the United States, News and Analysis,* March 1989.

Destler, I.M., *American Trade Politics,* 2nd ed., (Washington, D.C.: Institute for International Economics, 1992).

Destler, I.M., Haruhiro Fukui, and Hideo Sato, *The Textile Wrangle: Conflict in Japanese-American Relations, 1969-1971* (Ithaca: Cornell University Press, 1979).

Destler, I.M., and C. Randall Henning, *Dollar Politics: Exchange Rate Policymaking in the United States* (Washington, D.C.: Institute for International Economics, 1989).

Destler, I.M., and Michael Nacht, "Beyond Mutual Recrimination: Building a Solid U.S.-Japan Relationship in the 1990s," *International Security,* Vol. 15, No. 3 (Winter 1990/91), pp. 92-119.

Downs, George, "The Rational Deterrence Debate," *World Politics*, Vol. 41, January 1989, pp. 225-38.

Dunning, John H., "British Investment in the United States 1860/1913," Chapter 4 in *Studies in International Investment* (London: Allen & Unwin, 1970).

---------, "British Investment in U.S. Industry," *Moorgate and Wall Street*, Autumn 1961, pp. 5-23.

Dutton, William S., *Du Pont* (New York: Charles Scribner's Sons, 1942).

Edelstein, M., "The Determinants of UK Investment Abroad, 1870-1913: The US Case," *Journal of Economic History*, Vol. 34, No 4 (December 1974), pp. 980-1007.

Ekblom, H. E., "European direct investments in the United States," *Harvard Business Review*, July-August, 1973.

Encarnation, Dennis J., *Rivals Beyond Trade: America versus Japan in Global Competition* (Ithaca: Cornell University Press, 1992).

Evens, Peter B., Harold K. Jacobson, and Robert D. Putnam, eds., *Double-Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: University of California Press, 1993).

Executive Office of the President, *International Economic Report of the President* (Washington, D.C.: U.S. Government Printing Office, 1973 & 74).

---------, "Joint Report of the Council on International Economic Policy and the Office of Management and Budget," *United States Government Data Collection Activities with Respect to Foreign Investment in the United States* (Washington,D.C.: U.S. Government Printing Office, 1975).

---------, Office of the Press Secretary, "United States Foreign Direct Investment Policy," December 26, 1991.

Fallows, James, "Containing Japan," *Atlantic Monthly*, May 1989, pp. 40-54.

---------, "Playing by Different Rules," *Atlantic Monthly*, September 1987, pp. 22-32.

Farnsworth, Clyde H., "Japanese Drop a U.S. Investment: Fanuc Nuclear Tie Had Upset Congress," *New York Times*, February 19, 1991.

---------, "U.S. Clears Japanese Stake In Atomic-Arms Toolmaker," *New York Times*, January 18, 1991.

Feldstein, Martin, ed., *The American Economy in Transition* (Chicago: National Bureau of Economic Research, 1980).

Ferejohn, John, "Rationality and Interpretation: Parliamentary Elections in Early Stuart England," in Kirsten Renwick Monroe, ed., *The Economic Approach to Politics: A Critical Reassessment of the Theory of Rational Action* (New York: HarperCollins, 1991).

Ferguson, Charles H., "The Competitive Decline of the U.S. Semiconductor Industry," testimony before U.S. Senate Subcommittee on Technology and the Law, February 26, 1987.

Forester, Tom, *High-Tech Society* (Cambridge: MIT Press, 1987).

Frank, Andre Gunder, *On Capitalist Underdevelopment* (Bombay: Oxford University Press, 1975).

Frank, Richard S., "Arab Boycotts Undermine U.S. Premise," *National Journal*, March 29, 1975.

---------, "Economic Report/Improved balance-of-payments prospects end to controls on foreign investment," *National Journal*, June 2, 1973, pp. 809-15.

Franko, Lawrence G., *The European Multinationals* (Stamford, Conn.: Greylock, 1976).

Frantz, Douglas, and Catherine Collins, *Selling Out: How we are letting Japan buy our land, our industries, our financial institutions, and our future* (Chicago: Contemporary Books, 1989).

Frieden, Jeffry A., *Banking On The World: The Politics of International Finance* (Oxford and New York: Basil Blackwell, 1989).

Friedman, George, and Meredith LeBard, *The Coming War with Japan* (New York: St. Martin's Press, 1991).

Funabashi, Yoichi, *Managing the Dollar: From the Plaza to the Louvre* (Washington, D.C.: Institute for International Economics, 1988).

Gerowin, Mina, "U.S. Regulation of Foreign Direct Investment: Current Developments and the Congressional Response," *Virginia Journal of International Law*, Vol. 15, No. 3 (Spring 1975), pp. 634-46.

Gilbert, Geoffrey, "Maritime Enterprise in the New Republic: Investment in Baltimore Shipping, 1789-1793," *Business History Review*, Vol. 58, No. 1 (Spring 1984), pp. 14-29.

Gilpin, Robert, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987).

---------, *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment* (New York: Basic Books, 1975).

---------,*War and Change in International Politics* (Cambridge: Cambridge University Press, 1981).

Gladwin, Thomas N., and Ingo Walter, *Multinationals Under Fire* (New York: Wiley, 1980).

Glickman, Norman J., and Douglas P. Woodward, *The New Competitors: How Foreign Investors Are Changing the U.S. Economy* (New York: Basic Books, Inc., 1989).

Gourevitch, Peter, *Politics in Hard Times* (Ithaca: Cornell University Press, 1986).

---------, "The second image reversed: the international sources of domestic politics," *International Organization*, Vol. 32, No. 4 (Autumn 1978), pp. 881-911.

Grafstein, Robert, "Rational Choice: Theory and Institutions," Kirsten Renwick Monroe, ed., *The Economic Approach to Politics: A Critical Reassessment of the Theory of Rational Action* (New York: HarperCollins, 1991).

Graham, Edward M., and Paul R. Krugman, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics, 1989).

Green, Constance McClaughlin, "Light Manufactures and the Beginnings of Precision Manufacture," in Harold F. Williamson, ed., *The Growth of the American Economy*, 2nd. ed. (Englewood Cliffs: Prentice-Hall, 1951).

Greenwald, John, "Friends or Foe?" *Time*, April 24, 1989.

Grieco, Joseph M., *Cooperation among Nations: Europe, America, and Non-tariff Barriers to Trade* (Ithaca: Cornell University Press, 1990).

Grossman, Gene M., and J. David Richardson, *Strategic Trade Policy: A Survey of Issues and Early Analysis*, Special Papers in International Economics, No. 15 (Princeton: International Finance Section, 1985).

Hammond, Bray, *Banks and Politics in America: From the Revolution to the Civil War* (Princeton: Princeton University Press, 1957).

Hass, Ernst B.,*The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957* (Stanford: Stanford University Press, 1958).

Hellman, Rainer,*The Challenge to U.S. Dominance of the International Corporation* (New York: Dunellen, 1970).

"High Noon for Fujitsu: Japan's Top Computer Maker Tries to Fight Off IBM and Keep Growing," *Electronics*, May 26, 1986.

Howeth, L. S., *History of Communications-Electronics in the United States Navy* (Washington, D.C.: Government Printing Office, 1963).

Huntington, Samuel, "America's Changing Strategic Interests," *Survival*, Vol. 23, No. 1 (January/February 1991).

Hutchins, John G., *American Maritime Industries and Public Policy, 1789-1914* (Cambridge: Harvard University Press, 1941).

Ikenberry, G. John, ed., *American Foreign Policy: Theoretical Essays* (Glenview, Illinois: Scott, Foresman and Company, 1989).

---------, "Conclusion: An Institutional Approach to American Foreign Economic Policy," *International Organization*, Vol. 42, No. 1 (Winter 1988), pp. 219-43.

---------, *Reasons of State: Oil Politics and the Capacities of American Government* (Ithaca: Cornell University Press, 1988).

International Monetary Fund, *World Economic Outlook: Revised Projections of the Staff of the International Monetary Fund*, October 1988.

Ishihara, Shintaro, *The Japan That Can Say No: Why Japan Will Be First Among Equals* (New York: Simon & Schuster, 1989).

"Japan Survey," *The New York Times*, July 10, 1990.

Jeremy, David J., "British Textile Technology Transmission to the United States: The Philadelphia Region Experience 1770-1820," *Business History Review*, Vol. 47, No. 1 (Spring 1973), pp. 24-52.

Johnson, Charlmer "Their Behavior, Our Policy," *The National Interest*, No. 17 (Fall 1989), pp. 17-27.

Julius, DeAnne, *Global Companies & Public Policy: The Growing Challenge of Foreign Direct Investment* (New York: Council on Foreign Relations Press for The Royal Institute for International Affairs, 1990).

Julius, DeAnne, and S. Thomsen, "Foreign-owned Firms, Trade, and Economic Integration," *Tokyo Club Papers 2* (London: Royal Institute of International Affairs, 1988).

Katzenstein, Peter J., "Conclusion: Domestic Structures and Strategies of Foreign Economic Policy," in Peter J. Katzenstein, ed., *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Madison: University of Wisconsin Press, 1978).

----------, "International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States," *International Organization,* Vol. 30, No.1 (Winter 1976), pp. 1-45.

Kearns, Kevin L., "After FSX: A New Approach to U.S.-Japan Relations," *Foreign Service Journal,* December 1989, pp. 43-8.

Kennedy, Paul,*The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Random House, 1987).

Keohane, Robert O., and Joseph S. Nye, *Power and Interdependence: World Politics in Transition* (Boston: Little, Brown, 1977).

Kernell, Samuel, ed., *Parallel Politics: Economic Policymaking in Japan and the United States* (Washington, D.C.: The Brookings Institution, 1991).

Kindleberger, Charles P., *Power and Money: The Politics of International Economics and the Economics of International Politics* (New York: Basic Books, 1970).

Kissinger, Henry A., and Cyrus R. Vance, "Bipartisan Objectives for American Foreign Policy," *Foreign Affairs,* Vol. 66, No. 5 (Summer 1988), pp. 899-921.

Krasner, Stephen D., *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Berkeley: University of California Press, 1978).

----------, ed., *International Regimes* (Ithaca: Cornell University Press, 1983).

----------, "State Power and the Structure of International Trade," *World Politics,* Vol. 28, April 1976, pp. 317-47.

Kraus, Lawrence, "Managed Trade: The Regime of Today and Tomorrow," *Journal of Asian Economics,* Vol. 13, Fall 1992, pp. 301-14.

Krugman, Paul R., "New Theories of Trade Among Industrial Countries," *American Economic Review,* Vol. 73, May 1983, pp. 343-7.

Kudrle, Robert T., "Good for the gander? foreign direct investment in the United States," *International Organization*, Vol. 45, No. 3 (Summer 1991), pp. 397-424.

Lachica, Eduardo, "Foreign Stakes In U.S. Technology Are Under Review," *Wall Street Journal*, October 11, 1990.

---------, "Japan's Fanuc Ends Bid to Buy 40% Of Firm Doing Sensitive U.S. Job," *Wall Street Journal*, February 20, 1991.

Lakatos, Imre, *The methodology of scientific research programmes: Philosophical Papers Volume 1* (Cambridge: Cambridge University Press, 1978), p. 4.

Lake, David, "International Economic Structures and American Foreign Economic Policy," *World Politics*, Vol. 35, July 1983, pp. 517-43.

Latham, Earl, "The Group Basis of Politics: Notes for a Theory," *American Political Science Review*, Vol. 46, No. 2 (June 1952), pp. 376-97.

Lawrence, Robert Z., "Imports in Japan: Closed Markets or Minds?" *Brookings Papers on Economic Activity*, 2 (Washington, D.C.: The Brookings Institution, 1987).

Lewis, Cleona, *America's Stake in International Investment* (Washington, D.C.: The Brookings Institution, 1938).

Lewis, Paul, "Economic Report/Welcome mat still out for foreign investors in the U.S.," *National Journal*, January 10, 1976, p. 32-3.

---------, "OPEC's Takeover Threat," *National Journal*, January 10, 1976, p. 37.

Lindsay, James M., "Congress and Foreign Policy: Why the Hill Matters," *Political Science Quarterly*, Vol. 107, No. 4, pp. 607-28.

Lipsey, Robert E., "Foreign Direct Investment in the U.S.: Changes over Three Decades," *NBER Working Papers*, 4124 (Cambridge, MA: National Bureau of Economic Research, Inc., July 1992).

Lowi, Ted, "American Business, Public Policy, Case-Studies, and Political Theory," *World Politics*, Vol. 16 (1964), pp. 677-715.

MacLaurin, W. Ruper, *Invention and Innovation in the Radio Industry* (New York: Macmillan Inc., 1949).

Malone, Michael, "Fear and Xenophobia in Silicon Valley," *Wall Street Journal*, February 23, 1987.

Mann, Catherine L., "Determinants of Japanese Direct Investment in U.S. Manufacturing Industries," *International Finance Discussion Papers*, 362, (Washington, D.C.: Board of Governors of the Federal Reserve, September 1989).

Mann, Thomas, ed., *A Question of Balance: The President and the Congress and Foreign Policy* (Washington, D.C.: The Brookings Institution, 1990).

March, James, and Johan Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review*, Vol. 78, 1984, pp. 734-49.

Mayhew, David R., *Congress: The Electoral Connection* (New Haven: Yale University Press, 1974).

McClain, David S., "Foreign Investment in U.S. Manufacturing and the Theory of Direct Investment," (unpublished doctoral thesis, Massachusetts Institute of Technology, September 1974).

McCubbins, Mathew D., Roger G. Noll, and Barry R. Weingast, "Administrative Procedures as Instruments of Political Control," *Journal of Law, Economics, and Organization*, Vol. 3, No. 2 (1987), pp. 243-77.

---------, "Positive and Normative Models of Due Process: An Integrative Approach to Administrative Procedures," Stanford, CA: Hoover Institution, Working Paper P-90-10.

---------, "Structure and Process, Politics and Policy: Administrative Arrangements and Political Control of Agencies," *Virginia Law Review*, Vol. 75, March 1989, pp. 431-82.

McCubbins, Mathew, and Thomas Schwartz, "Congressional Oversight Overlooked: Police Patrol Versus Fire Alarms," *American Journal of Political Science*, Vol. 28, February 1984, pp. 165-79.

McKeown, Timothy, "Firms and Tariff Regime Change: Explaining the Demand for Protection," *World Politics*, Vol. 36, January 1984, pp. 215-33.

Milner, Helen V., *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton: Princeton University Press, 1988).

Mitrany, David, *A Working Peace System* (Chicago: Quadrangle, 1966).

Moe, Terry M., "The New Economics of Organization," *American Journal of Political Science*, Vol. 28, No. 4 (November 1984), pp. 739-77.

---------, "President, Institutions, and Theory," in George C. Edwards III, John H. Kessel, and Bert A. Rockman, eds., *Researching the Presidency: Vital Questions, New Approaches* (Pittsburgh: University of Pittsburgh Press, 1993).

---------, "On the Scientific Status of Rational Choice Theory," *American Journal of Political Science*, Vol. 23, No. 1 (February 1979), pp. 215-43.

Muramatsu, Michio, and Ellis Krauss, "Bureaucrats and Politicians in Policymaking: The Case of Japan," *American Political Science Review*, Vol. 78, March 1984, pp. 126-46.

Naon, Horacio A. Grigera, "Transnational Enterprises under the Pacto Andino and National Laws of Latin America," in Norbert Horn, ed., *Legal Problems of Codes of Conduct for Multinational Enterprises* (Kluwer-Deventer/The Netherlands: Studies in Transnational Law, 1980).

National Advisory Council, *Annual Report to the President and to the Congress for 1977* (Washington, D.C.: Government Printing Office, 1978).

"The New Competition From Foreign-Based Multinationals," *Business Week*, July 7, 1973, pp. 56-65.

Nicolaides, Phedon, "Investment Policies in an Integrated World Economy," *The World Economy*, Vol. 14, No. 2 (June 1991), pp. 121-37.

Niehuss, John, "Foreign Investment in the United States: A Review of Government Policy," *Virginia Journal of International Law*, Vol. 16, No. 1 (Fall 1975), pp. 65-102.

Niskanen, William A., "Bureaucrats and politicians," *Journal of Law and Economics*, Vol. 18, December 1975, pp. 617-43.

Nivola, Pietro S., *Regulating Unfair Trade* (Washington, D.C.: The Brookings Institution, 1993).

Nordlinger, Eric A., "The Return to the State: Critiques," *American Political Science Review*, Vol. 82, No. 3 (September 1988), pp. 875-85

Nye, Jr., Joseph S., "Comparing Common Markets: A Revised Neo-Functional Model," in Leon N. Lindberg and Stuart A. Scheingold, eds., *Regional Integration: Theory and Research* (Cambridge: Harvard University Press, 1971), pp. 192-231.

Odell, John S., "Understanding International Trade Policies: An Emerging Synthesis," *World Politics*, Vol. 43, October 1990, pp. 139-67.

---------, "The U.S. and the emergence of flexible exchange rates: an analysis of foreign policy change," *International Organization,* Vol. 33, No. 1 (Winter 1979), pp. 57-81.

OECD, *Recent International Direct Investment Trends* (Paris: OECD, 1981).

Ohmae, Kenichi, *The Borderless World,: Power and Strategy in the Interlinked Economy* (New York, Harper Business/HarperCollins Publishers, 1990).

Olson, Mancur L., *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge: Harvard University Press, 1965).

Omestad, Thomas, in "Selling Off America," *Foreign Policy,* No. 76, Fall 1989, p. 119-40.

Organization for International Investment, "Foreign Investment in the U.S.: A Fact Guide," Washington, D.C., February 1993.

Ott, Mack, "Is America Being Sold Out?" excerpted in Jeffry A. Frieden and David A. Lake, eds., *International Political Economy: Perspectives on Global Power and Wealth,* 2nd ed. (New York: St. Martin's Press, Inc., 1991), pp. 220-9.

Ozawa, Terutomo, *Multinationalism, Japanese Style: The Political Economy of Outward Dependency* (Princeton: Princeton University Press, 1979).

Pastor, Robert A., *Congress and the Politics of U.S. Foreign Economic Policy* (Berkeley: University of California Press, 1982).

Peltzman, Samuel, "Toward a More General Theory of Regulation," *Journal of Law and Economics,* Vol. 19, 1976, pp. 211-40.

Pincus, Jonathan, J., *Pressure Groups and Politics in Antebellum Tariffs* (New York: Columbia University Press, 1977).

Pine, Art, "U.S. Considers Challenging the Merger of Schlumberger and Fujitsu Chip Units," *Wall Street Journal,* October 31, 1986.

Pollack, Andre, "After a Long Fight, U.S. Yields on a Vital Chip-Making Tool," *New York Times,* June 6, 1993.

Pollard, Robert A., *Economic Security and the Origins of the Cold War: 1945-1950* (New York: Columbia University Press, 1985).

Porter, Michael E., "The Competitive Advantage of Nations, " *Harvard Business Review,* March-April 1990, pp. 73-93.

Posner, Richard L., "Theories of Economic Regulation," *Bell Journal of Economics and Management Science*, Vol. 5, Autumn 1974, pp. 335-58.

Prestowitz, Clyde V., *Trading Places: How We Allowed Japan to Take the Lead* (New York: Basic Books, 1988).

Price, David, *Who Makes the Laws?* (Cambridge, Mass.: Schenkman Publishing Company, 1972).

Putnam, Robert D., "Diplomacy and domestic politics: the logic of two-level games," *International Organization*, Vol. 42, No. 3 (Summer 1988), pp. 427-60.

Reich, Robert, "Do We Want U.S. to Be Rich Or Japan Poor?" in *Wall Street Journal*, June 18, 1990.

Reich, Simon, "Roads to follow: regulating direct foreign investment," *International Organization*, Vol. 43, No. 4 (Autumn 1989), pp. 543-83.

Robertson, Jack, "Say Near-Buy of Fairchild Periled Cray R & D," *Electronic News*, March 30, 1987.

Rohrlich, Paul Egon, "Economic culture and foreign policy: the cognitive analysis of economic policy making," *International Organization*, Vol. 41, No. 1 (Winter 1987), pp. 61-92.

Rosecrance, Richard, *The Rise of the Trading State: Commerce and Conquest in the Modern World* (New York: Basic Books, Inc., 1986).

Rosenthal, Andrew, "Bush Urged to Void Sale of Airplane-Parts Maker to Chinese," *New York Times*, February 2, 1990.

Ross, Stephen A., "The economic theory of agency: The principal's problem," *American Economic Review*, Vol. 63, May 1973, pp. 134-9.

Safire, William, "Goodbye, Mr. Chips," *New York Times*, January 26, 1987.

Salvatore, Dominick, "Trade Protection and Foreign Direct Investment in the U.S.," in *The Annals of the American Academy of Political and Social Science*, Vol. 516, July 1991, pp. 91-105.

Sanger, David E., "Kubota's Strategy Sparks Fears About Technology Losses," *New York Times*, September 7, 1988.

Schattshneider, E. E., *Politics, Pressures and the Tariff* (New York: Prentice-Hall, 1935).

Servan- Schreiber, Jean-Jacques, *The American Challenge* (New York: Atheneum, 1968).

Shepsle, Kenneth A., "Institutional Equilibrium and Equilibrium Institutions" in Herbert F. Weisberg, ed., *Political Science: The Science of Politics* (New York: Agathon, 1986).

Spence, Michael and Richard Zeckhauser, "Insurance, information, and individual action," *American Economic Review*, Vol. 61, May 1971, pp. 380-7.

Spencer, Linda, "Foreign Investment in the United States: Unencumbered Access," Washington, D.C., Economic Strategy Institute, May 1991.

Stegemann, Klaus, "Policy rivalry among industrial states: what can we learn from models of strategic trade policy?" *International Organization*, Vol. 43, No. 1 (Winter 1989), pp. 73-100.

Strange, Susan, "*Cave! hic dragones*: a critique of regime analysis," *International Organization*, Vol. 36, No. 2 (Spring 1982), pp. 337-54.

Supple, Barry E., ed., *The Experience of Economic Growth* (New York: Random House, 1963).

Tharp, Mike, "Uncertainty on Fairchild-Fujitsu Plan Grows as Justice Agency Begins Review," *Wall Street Journal*, November 17, 1986.

Tolchin, Martin and Susan, *Buying Into America: How Foreign Money is Changing the Face of Our Nation* (New York: Times Books).

---------, *Selling Our Security: The Erosion of America's Assets* (New York: Alfred A. Knopf, 1992).

Truman, David, *The Governmental Process: Political Interests and Public Opinion* (New York: Knopf, 1951).

"2 In Cabinet Fight Sale to Japanese," *New York Times*, March 12, 1987.

U.S. Department of Commerce, *Foreign Direct Investment in the United States* (Washington, D.C.: U.S. Government Printing Office, August 1991).

---------, *U.S. FDI: 1988 Annual Survey* (Washington, D.C.: Government Printing Office, 1988).

---------, Bureau of Economic Analysis,*Survey of Current Business* (Washington, D.C.: U.S. Government Printing Office, various issues).

---------, Bureau of Export Administration, Office of Industrial Resources Administration, *National Security and the State of the U.S. Industrial Base* (Washington, D.C.:U.S. Government Printing Office, 1991).

---------, Investment Analysis Division, Office of Trade and Economic Analysis, "Recent Trends in International Direct Investments: The Boom Years Fade," August 1993.

U.S. Department of Defense, Defense Science Board Task Force, *Defense Semiconductor Dependency* (Washington, D.C.: U.S. Government Printing Office, 1987).

---------, *Report of the Task Force on Industrial Responsiveness* (Washington, D.C.: U.S. Government Printing Office, 1980).

U.S. Department of State, John Hay's letter to Reginald Tower, April 27, 1899, in *Foreign Relations of the United States, 1899* (Washington, D.C.: U.S. Department of State, 1899).

U.S. House of Representatives, Defense Industrial Panel of the House Armed Services Committee, *The Ailing Defense Industrial Base: Unready for Crisis*, Report, 96th Congress, 2nd sess. (Washington, D.C.: U.S. Government Printing Office, 1980).

---------, "Disclosure of Foreign Investment in the United States," hearing before the Subcommittee on Telecommunications, Consumer Protection, and Finance, Committee on Energy and Commerce, 99th Congress, 2nd Session, on H.R. 2582 and H.R. 4242, serial no. 99-125, May 8, 1986.

Van Wolferen, Karel, *The Enigma of Japanese Power: People and Politics in a Stateless Nation* (London: Macmillan, 1989).

Vaupel, James, and Joan Curhan, *The World's Multinational Enterprises* (Boston: Graduate School of Business, Harvard University, 1973).

Vernon, Raymond, "Are Foreign-owned Subsidiaries Good for the United States?" Occasional Papers, No. 37, Group of Thirty, Washington, D.C.

---------, "International Investment and International Trade in the Product Cycle," in Robert E. Baldwin and J. David Richardson, *International Trade and Finance: Readings*, 2nd. ed. (Boston: Little, Brown, 1981), pp, 27-40

---------, *Sovereignty at Bay* (New York: Basic Books, 1971).

Walters, Donna K. H., and William C. Rempel, "A One-Time Winner Is Out of Chips," *Los Angeles Times*, December 1, 1987.

---------, "Trade War: When Chips Were Down," *Los Angeles Times*, November 30, 1987.

Waltz, Kenneth N., *Theory of International Politics* (New York: Random House, 1979).

Warshofsky, Fred, *The Chip War: The Battle for the World of Tomorrow* (New York: Charles Scribner's Sons, 1989).

Weingast, Barry R., and Mark Moran, "Bureaucratic discretion or congressional control: Regulatory policymaking by the Federal Trade Commission," *Journal of Political Economy*, Vol. 91, October 1983, pp. 765-800.

Wrong, Dennis, *Power, Its Forms, Bases, and Uses* (New York: Harper and Row, 1979).

Yoffie, David B., "American Trade Policy: An Obsolete Bargain?" in John E. Chubb and Paul E. Peterson, eds., *Can the Government Govern?* (Washington, D.C.: The Brookings Institution, 1989).

Yoon, Young-Kwan, "The Political Economy of Transition: Japanese Foreign Direct Investment in the 1980s," *World Politics*, Vol. 43, October 1990, pp. 1-27.

Zysman, John, "Contribution or Crisis: Japanese Foreign Direct Investment in the United States," in Kozo Yamamura, ed., *Japanese Investment in the United States: Should we be concerned?* (Seattle: Society for Japanese Studies, 1989).