Foreign Investment: Law and Policy Seminar
Professor Alvarez
Fall 2017

Course Description

This seminar addresses the legal rules and policies, both domestic and international, governing an area of vital international economic activity. International investment law, whether or not considered a distinct “regime”, is a fast-growing subject that involves a unique blend of public international law, procedures drawn from commercial arbitration, and “public law” concerns.

This seminar briefly examines relevant domestic laws, particularly within the United States, but focuses especially on the international law that purports to regulate incoming and outgoing foreign investment, namely the over 3000 International Investment Agreements (IIAs) consisting of Bilateral Investment Treaties (BITs), the investment chapters of free trade agreements (FTAs) (such as Chapter 11 of the North American Free Trade Agreement (NAFTA)), and customary international law (such as the “international minimum standard” of treatment and rules demanding prompt, adequate and effective compensation upon expropriation). These sources establish the type of treatment that ought to be accorded foreign investors that seek to establish themselves in a foreign territory or that should apply to such investment once established in a host country. The seminar focuses particularly on foreign direct investment (FDI), including “greenfield” investments (consisting of new enterprises established on the territory of a host state) and mergers and acquisitions where a foreign company takes over a local enterprise. The class also introduces students to the favored tool for settling disputes between foreign investors and their host states, namely investor-state dispute settlement (ISDS) and some of the burgeoning “jurisprudence constante” emerging as a result of increasingly public arbitral awards.

Foreign investment is subject to diffuse regulation and is not governed by just one overriding treaty or institutional regime. Much of the terrain is contested. What is “foreign” about investment is as contested as whether or not something is “investment”. By contrast to trade in goods – and the World Trade Organization – this is a subject governed by no single multilateral treaty but by many in which no single judicial body, international or national, dominates. To complicate matters further, the literature on the subject, though relatively recent, is vast, and there are a number of perspectives (from sociological to historical) possible.

To make the subject more manageable and to lend coherence, this seminar will focus on only select topics. It will principally address (1) the theoretical and policy background that helps explain the emergence and evolution of IIAs and ISDS; (2) some of the substantive legal standards that are applied in the course of ISDS such as the meaning and import of “fair and equitable treatment” and “national treatment”; (3) the “legitimacy” or “rule of law” concerns arising from IIAs and ISDS; and (4) some of the policy responses to those concerns that are now emerging (such as the turn to amicus briefs, greater transparency and possibly international investment courts instead of ISDS). All of these issues will be principally addressed through role-playing. Students will often be asked to assume the role of an investor, a state official defending its laws and regulations, an arbitrator, or other stakeholders in the international investment regime (such as a human rights NGO or a third party state that is not a litigant in an
investor-state dispute but may be, for example, another state party to the IIA being addressed in an investor-state arbitration). The goal of the class is to improve the skills of prospective practitioners in this field – whether they act as adjudicators, experts, or as legal advisers in a law firm, an NGO, or a foreign ministry.

A few more words about what the class is not about. This is a class which focuses on regulation and arbitral decisions resulting from discrete investment disputes, and not the “art of the deal”. It is not a course about bargaining in international business transactions nor is it about the underlying contracts that characterize such deals. This seminar also avoids most of the procedural issues surrounding the bringing of investor-state claims. This course does not have a “law and economics” bent and no economics knowledge is assumed (although some might be useful background).

There is some overlap between the topics addressed in this seminar and those addressed in other investment arbitration courses or seminars taught at NYU. Students are not barred from taking those other courses in addition to this one. Students in this course will find that a background in international law would be useful but prior courses on public international law or arbitration are not a formal prerequisite. (But those who have not taken an international law course at any time in the past are strongly encouraged to, over the first weeks of term, become familiar with the basic sources of international law (treaty and custom) in a basic text, such as the West Nutshell book on Public International Law.)
Seminar Requirements

This is a semester long two credit seminar, with two hour class meetings on a weekly basis. Like many seminars it demands considerable reading (sometimes exceeding 100 pages a week) and requires students to have done these readings before the course meets to make class discussions meaningful. The class will be devoted to discussing these readings as a group. Readings for the course will generally be available on the courseweb or, in rare cases due to copyright restrictions, on course reserve in the law library. Readings will be posted on the course website regularly. The general topics that the professor expects to cover are enumerated below.

The class meets on Thursdays, from 3-4:50 p.m. in Furman Hall 324. The only required book (available for purchase) is a paperback, J.E. Alvarez, The Public International Law Regime Governing International Investment (2011).

Class attendance and participation are essential. **If you anticipate that you will not be able to attend any sessions due to call-backs or other commitments, you are urged not to enroll in this class.** As with most seminars, students should come ready to participate actively in class discussion and that includes the first class. This is not a lecture course. **Starting with the fourth class meeting, all students will be required to submit weekly “reaction papers” responding to one of the questions raised in the assigned readings for that week. These reaction papers anticipate the discussion that will occur in class that week; they are not a reaction to the preceding week’s readings.** Students’ reaction papers, which must be posted on the courseweb page 24 hours before the class meets (that is, by Tuesdays at 3 p.m.,) must be no more than 500 words in length with the exception of the first and last reaction papers (which have a 1000 word limit). Papers submitted late will be severely penalized as the whole point of the exercise is to permit the professor and all students to use the reaction papers to prepare for class discussion the following day. Students should attempt, when possible, to read or at least skim the reaction papers of other class members prior to the class to be fully prepared for class discussion. **Students should, of course, bring a hard copy of their own reaction paper to class (the better to defend their views).** (A sample reaction paper written by a former student, along with a helpful explanation (written by another professor who asks for a similar paper; entitled “what I mean by a critique”) is included in the first week’s readings folder.) The final reaction paper, the only one that is to be submitted after the relevant class meets, is due on the first day of exam period for this fall term.

**The ten reaction papers submitted over the course of the semester as well as weekly class participation will be the basis of a student’s final grade.** Students are encouraged to come at least once during the professor’s office hours (which will be posted for weekly sign ups outside the professor’s office in Vanderbilt 325) at any time during the semester to discuss their reaction papers.

Students who have not yet been admitted to the course but who are seriously interested should come to the first scheduled class as in the past a high number of students have exercised their option to add/drop and most students who want to be registered have eventually been able to do so. Persistence pays off.
Optional (One Credit) Research Paper

Registered students in the class have the option of writing, in addition to the reaction papers required for the course, an optional research paper on any topic related to the subject matter of the course, for an additional (third) academic credit.

Topics for these papers can address subjects covered in the course or those that are not, such as different guarantees covered in IIAs or the prospect of annulments of arbitral awards. Students seeking to write optional research need to consult with the professor to be sure that both student and instructor agree on a suitable topic and on a proposed schedule for completing the first and final draft. (This should be done no later than the 4th class meeting of the course.) These optional research papers tend to be no more than 10-15,000 words including footnotes. For an example of such a paper written by a former student in the course see Christopher Fenton, Student Note, “U.S. Policy Towards Foreign Direct Investment Post-September 11th: Exon-Florio in the Age of Transnational Security,” 41 Columbia J. Transnational L. 195 (2002). (As will be evident, that published student note was a considerably expanded version of the original shorter paper written for this class.) Those looking for possible current topics on which to write a research paper may consider getting ideas from, for example, the occasional short Perspectives issued by Columbia’s Center on Sustainable Development, at http://ccsi.columbia.edu/publications/columbia-fdi-perspectives.

Suggested Optional Background Reading (available at most bookstores):

Thomas Friedman, The Lexus and the Olive Tree (2d ed. 2000) (also on library reserve)

Other books on course reserve in the Law Library that may be of interest:

Dolzer and Schreuer, Principles of International Investment Law (2nd ed. 2012)

Marans et al, Manual of Foreign Investment in the United States (3rd ed. 2004 with pocket updates through Dec. 2013. This is an ebook available through Westlaw. The third edition, updated Dec. 2013, is available at https://julius.law.nyu.edu/record=b1973244~S0 (click inside the box that says “Online Access Provided by WestlawNext...” and then log in with your Westlaw password).
Jan Paulsson, Denial of Justice in International Law (2005)
Karl Sauvant and Lisa Sachs, The Effect of Treaties on Foreign Investment (OUP 2009)
Stephan Schill, The Multilateralization of International Investment Law (CUP 2009)
M. Sornarajah, The International Law on Foreign Investment (3d ed. 2010)
Tentative Syllabus

Class 1: Introduction to “Foreign Direct Investment” (FDI): Its Causes, Its Alleged Benefits

Class 2: How did we get here? The Evolving International Investment Regime

Class 3: An introduction to national laws on FDI

Class 4: Learning to read and apply Bilateral Investment Treaties (BITs)(FIRST REACTION PAPER Due 24 hours prior to class meeting)

Class 5: Other international law obligations governing FDI

Class 6: Introducing the NAFTA’s Chapter Eleven

Class 7: Non-Discriminatory or National Treatment and the Alleged Connections to WTO law

Class 8: Expropriations and Regulatory Takings

Class 9: Fair and Equitable Treatment

Class 10: The Argentina Crisis and the Defense of “Necessity”

Class 11: Transparency, Amicus, and the “Public Interest”


Class 13: Criticisms and “Re-balancing” IIAs in Response

Class 14: Beyond ISDS?
Week One
Introduction: Accounting for FDI flows

Readings:


Robert B. Reich, “Who Do We Think They Are?” The American Prospect 49 (1991) (on courseweb)


Optional Reading for those interested in the investment chapter of the TPP:
(Note that despite the U.S. withdrawal from TPP negotiations, those negotiations are apparently continuing among the other 10 TPP countries.)

Optional Reading for those interested in economic analysis:

Questions for Class Discussion:
The readings for this week present some basic facts about foreign investment. They also introduce the policy debates that incoming foreign investment periodically poses even for an advanced economy such as the United States – from the Clinton Administration facing a significant wave of FDI in early 1990s to today’s Trump Administration facing a strong Chinese wave of FDI today.

We will focus on three basic issues: (1) the causes of foreign investment flows; (2) the alleged “benefits” that result from incoming foreign investment; and (3) the perceived detriments and consequential reactions to incoming investment. Addressing these questions is essential to understanding the rules, national and international, that countries have devised to handle investment flows.
On the first point, note from the UNCTAD data that state-owned MNEs continue to have a growing role, including with respect to “greenfield” investments and that new national laws governing foreign investment vary greatly (and no longer point only in the direction of making things easier for transnational capital flows with some 1/5 of new laws imposing restrictions on incoming FDI). The UNCTAD Report also indicates that the universe of (ever more complex) IIAs continues to rise (to some 3324 treaties), amidst lots of proposals for reforming existing old treaties. But note that even as international and national laws governing FDI are becoming more varied, the countries that receive and send out the greatest number of foreign investors have remained fairly constant over time. Indeed, as is suggested by Figures 4 and 6 in the UNCTAD Report, many of the countries that are the leading exporters of capital are also leading recipients of foreign capital.

Based on your own general knowledge, what accounts for some of these facts, e.g., what makes countries like the U.S. and China leading recipients of FDI? What are investors looking for in the U.S. or in China? What encourages U.S. or Chinese companies to invest abroad? What might impede or discourage a U.S. business from investing abroad, including in China?

On the second set of issues, start with the distinct points of view of Reich and Tyson. What is “foreign” about foreign investment? What exactly differentiates Reich from Tyson? Do they differ on the benefits foreign investment brings to the United States? Do they differ on the types of government policies that the U.S. should adopt with respect to foreign investors? Keep in mind that at the time they wrote these articles both Reich and Tyson were members of the same (Clinton) Administration. What do you think about the proposal to insist on “true reciprocity” with respect to investment flows? Why do you think that so far the U.S. has mostly avoided reciprocity based FDI policies?

If you were an adviser to the Trump Administration today what view would you take on these topics? Would you, for example, encourage the Administration to resist future multilateral treaties (like the TPP that Trump withdrew from on his third day in office) that are designed to encourage transnational capital flows like the NAFTA while still concluding bilateral treaties (known as BITs) that do the same? (Note that neither of these types of IIAs insist on reciprocity.)

On the third set of issues: Note that according to UNCTAD, the U.S. remains the top country for both FDI inflows and outflows (with incoming FDI exceeding outflows). The leading foreign investors in the U.S. are Western Europeans (8 of which account for 80% of all of its FDI inflows). But as the following article from Forbes indicates, Chinese investors lead the pack in terms of investing in U.S. real estate (particularly in places like NYC, see http://www.iilj.org/publications/1887/). What do you think are the problems/fears generated by incoming FDI for a developed economy like that of the United States where FDI flows remain a low percentage of the overall economy? Should the United States worry about either the inflows or outflows of FDI? What potential threats do Chinese investors in particular pose to U.S. interests?
Week Two

How Did We Get Here? The Evolving International Investment Regime

Readings:
O. Thomas Johnson, Jr. and Jonathan Gimblett, “From Gunboats to BITs: The Evolution of Modern International Investment Law” (Chapter One from Alvarez, International Investment Law) (on courseweb)
J.E. Alvarez, Chapter One from The Public International Law Regime Governing International Investment (required book available for purchase)

Questions for Class Discussion:

The Kuruk piece describes one way that rules are established to govern foreign investment: negotiate contracts between host countries and investors. What does the Kuruk piece suggest are the downsides to that approach? Do you think that those downsides are limited to poor countries like Ghana or limited to investments dealing with natural resources such as oil? Are the “lessons” that Kuruk draws still relevant today? What other constraints exist on using the vehicle of contract to govern FDI rules?

Johnson-Gimblett’s essay suggests another vehicle that remains in use on occasion to resolve disputes arising from foreign investment: diplomatic espousal between the host state of a foreign investor and the home country of the investor. What are the advantages and disadvantages of that approach? Why did that approach come to be displaced (at least sometimes) by Treaties of Friendship, Commerce and Navigation and later by bilateral investment treaties (BITs)? What exactly did BITs supply that FCNs did not? Does this historical account suggest that the international investment regime predominately reflects the views and preferences of Western wealthy states?

The contemporary international investment regime, described by Alvarez, offers considerable benefits to foreign investors but is subject to considerable critiques. From the standpoint of an investor (or a lawyer for one), what are the pros and cons of the current regime’s reliance on thousands of treaties and investor-state dispute settlement? From the point of view of a lawyer for a host state to foreign investors, what are the pros and cons of the international investment regime? IIAs and ISDS differ from both the WTO and regional human rights courts. What accounts for the differences? Which of the criticisms of IIAs/ISDS are so serious that they merit fundament change in how foreign investors are treated or where their disputes with host states ought to be resolved?
capital gains cut. Still, the DNC, compared to its Republican counterpart, remains chronically strapped for funds and is thus less of an institutional player.

Normally, an opposition philosophy is also defined by its elder statesmen. On this front, the Democrats are more bereft than usual. Most of the New Dealers are now deceased; the last survivors are in their seventies or older. Veterans of the Carter administration include many Democrats of the scuttle-to-the-center school, such as Stuart Eizenstat, Charles Schultze, and Robert Strauss, who think budget discipline is paramount, big spending got the Democrats in trouble, and equity has to be sacrificed to growth. These are voices of neoliberalism, if not conservatism.

Another reservoir of statesmen is former presidents and presidential candidates. These, unfortunately, are now famous mainly for calamitous ‘defeats. And, although party philosophy may be defined in new presidential candidates, the candidates first have an understandable need for product differentiation. Once nominated, they appeal for unity but along the way they are typically a force for division rather than cohesion.

For better or for worse, the congressional party must define what Democrats are all about. Paradoxically, by being clearer about what the party stands for congressional Democrats make the Congress look better, not worse, as they did when Congress rescued the budget and Social Security, and began salutary debates on Vietnam, Watergate, the Persian Gulf, and such popular domestic issues as universal health insurance and child care.

The Democrats are not virgins, but for the moment they have climbed out of the presidential bed. They should stay out. It is, of course, far better to dwell in carnal bliss with a president of the same persuasion, and far easier to define a coherent ideology from the White House. But first, a Democrat has to get there. That journey is still arduous, yet more likely to be successful if the party knows where it is going.

They Are Not Us
Why American Ownership Still Matters
Laura D’Andrea Tyson

Like “Engine” Charlie Wilson, the colorful chief executive of General Motors in the years after World War II, most Americans intuitively assume that what is good for American companies like GM is good for the nation. The competitiveness of the U.S. economy, most Americans believe, means the competitiveness of corporations based in the United States. This identity of interests has been so widely taken for granted that only a few theorists of the obvious, like Engine Charlie and Calvin Coolidge (“The business of America is business”), have ever seen a need to express it.

The tradition of identifying nations and corporations extends far back into the past when corporations served the monarchs who gave them special charters. But whether that premise makes sense today is not at all clear. The actual behavior of many American corporations shows that they do not always act as if national loyalty were their guiding motivation. Corporations are quick to relocate to remote countries with lower wages, less demanding social standards, or national laws requiring local production.

Indeed, some are now suggesting that national corporations are entirely a thing of the past. In several articles and an upcoming book that have crystallized the issue, Robert B. Reich warns that as American companies have become ever more global in their operations, the links between them and the U.S. economy are rapidly disappearing, and so policymakers must distinguish sharply between American economic interests and the economic interests of American companies. Whether the U.S. can provide high-wage jobs and support rising living standards depends, in Reich’s view, less on the strength of American companies than on the strength and competitiveness of the economic activities located within our borders.

On this fundamental insight, Reich’s logic is persuasive. He has framed precisely the right question: How are we to disentangle the interest of the nation-based corporation from that of the nation and its citizens? But the specifics of his analysis and his policy inferences can be challenged in two key respects.

First, his picture is, at best, premature. The economic fate of nations is still tied closely to the success of their domestically based corporations. Second, he assumes that globalization implies a symmetry of national economic policies, when in reality there are wide disparities. Many foreign markets are highly regulated, often to
America's disadvantage. Consequently, America cannot just foster the best possible workforce and then rely on market forces to bring high-wage jobs to our shores.

Reich argues his case by contrasting two hypothetical corporations. Corporation A, headquartered in the United States and owned by American investors, is an American company. But it is also a global one: Most of its employees are non-Americans, and it undertakes much of its research and development and product design and most of its complex manufacturing outside of the United States.

Corporation B, headquartered in a foreign country and owned primarily by foreign investors, is a foreign company. But, like Corporation A, it is also a global company. Much of its R&D and product design and most of its employment and manufacturing are located abroad—in the U.S.

Which of these two corporations is more important to the economic future of the United States? Or, as Reich asks, "Who is Us?"—Corporation A, the American company, or Corporation B, the foreign company? The answer seems obvious and counter to conventional wisdom.

But is the question fair? Have a significant number of American companies really globalized to such an extent that most of their economic activities are located abroad? And have foreign companies increased their investment in the United States so much that they now contribute as much or more to national economic competitiveness than American companies? Although both American and foreign companies are indeed becoming more global, as Reich suggests, the answer to both questions, for now and for the foreseeable future, is "no."

We Are Us

Despite several decades of substantial foreign direct investment by U.S. multinationals, the competitiveness of the U.S. economy remains tightly linked to the competitiveness of U.S. companies. U.S. multinationals still locate the lion's share of their worldwide operations within the U.S. In 1988, the last year for which data are available, U.S. parent operations accounted for 78 percent of the total assets, 70 percent of the total sales, and 74 percent of the total employment of U.S. multinationals. All of these shares were actually higher in 1988 than they were in 1977, the reverse of what one would expect if the links between the domestic economy and U.S. multinationals were precipitously disappearing, as Reich argues.

Within manufacturing, U.S. parent operations accounted for 78 percent of the total assets, 70 percent of the total sales, and 70 percent of the total employment of U.S. multinationals in 1988. The data reveal, moreover, that parent operations provided more productive jobs than affiliate operations. Assets per employee in the manufacturing parent operations were about 20 percent higher than in affiliate operations in developed countries and almost 200 percent higher than in affiliate operations in the developing countries. Similarly, compensation per employee in parent operations was about 17 percent higher than in affiliate operations in developed countries and about 360 percent higher than in affiliate operations in the developing countries. In short, American firms locate their "higher-end" jobs and operations at home.

Although American companies may have increased their overseas R&D spending by 33 percent between 1986 and 1988, compared with a 6 percent increase in R&D spending at home, the companies continue to spend the bulk of their R&D budgets within the United States. Between 1966 and 1982, the last year for which data are available, the share of R&D spending by U.S. multinationals in their overseas operations increased from 6.5 percent to only 8.9 percent. This overseas share was far lower than comparable shares for sales (29.4 percent) and assets (26.6 percent).

By 1988 the proportion of the total R&D spending by all U.S. companies that took place overseas had slipped to 8.6 percent, down from 9.4 percent in 1980. Again the trend does not support the notion of increasing globalization. In fact, according to John Dunning, a scholar who has done extensive research on multinationals, the available evidence suggests that except for some European firms and a few U.S. companies, such as General Motors, the average share of R&D activity undertaken by global companies outside their home countries is quite small. For Japanese firms it is negligible.

Outside of their home environments, global companies mainly produce goods and services, not innovations.

The leadership of American companies also remains overwhelmingly American. Despite an abundance of evidence by American corporate leaders on the globalization of American business, most large American companies do not have any foreigners on their boards of directors. According to a recent survey of directors by the executive search firm Korn Ferry, reported in The Economist, the proportion of the top 1,000 firms with a non-American on the board has declined from a recent peak of 17 percent in 1982 to only 12 percent in 1990.

So, overall, despite globalization, a disproportionate share of the activity of U.S. multinationals, especially their high-wage, high-productivity, research-intensive activity, remains in the United States. Of course, many American companies still engage in huge investments overseas. But these investments have not necessarily weakened domestic economic competitiveness. Indeed, the presumption should run the other way. Since American multinationals continue to locate the bulk of their high-quality, high-competitive activity in the U.S., the beneficial competitive effects of their overseas operations spill over into more and better jobs, higher profits, lower prices, and improved products at home.

For the foreseeable future, there are likely to be very few American corporations with a type-A personality—headquartered at home, but with most of their employees and complex manufacturing located abroad. U.S. multinational companies remain "us" in significant ways.

But Are "They" Also Us?

But what about the foreign multinationals that have established affiliate operations in the U.S.? Are they also us? In some industries, such as consumer electronics, U.S. national competitiveness now depends largely on foreign affiliates. In other industries, such as computers, U.S. competitiveness depends almost entirely on American companies, most of which have substantial overseas operations.

Instead of a simple yes or no answer to Reich's question, I suggest five propositions for assessing the contributions of foreign affiliates to national competitiveness.

**Proposition 1.** "They are becoming like us, but they have a long way to go."

Growing evidence indicates that, in certain ways, the affiliates of foreign companies operating in the U.S. resemble the domestic operations of American companies. Foreign affiliates are, on average, virtually indistinguishable from domestic firms in value-added per worker, compensation per worker, and R&D spending per worker, according to a recent study by Edward M. Graham and Paul R. Krugman.


The only significant difference found by Graham and Krugman is that the affiliates of foreign firms apparently import significantly more than do the parent operations of U.S. multinationals—almost two and one half times as much. Because many foreign affiliates were established recently—especially in the 1977-81 period when foreign direct investment in the U.S. grew rapidly—their dependence on imports will likely decline over time, as affiliates begin to rely on networks of local suppliers in the U.S. Affiliates of U.S. companies abroad have followed this pattern.

While on average they look increasingly like domestic companies, foreign affiliates differ sharply among themselves. At one extreme are foreign affiliates that are little more than assembly operations for foreign products. The Richo copier operation in California, for example, is an assembly plant with little domestic content.

At the other end of the spectrum are the extensive American operations of Honda, Sony, and Honda. Sony sells more cars in the United States than in Japan and has set up a largely independent design, production, and sales facilities in North America. The American content of the automobiles produced in the U.S. is fast approaching the American content of the automobiles made by Chrysler.

Foreign affiliates, whatever their character, still represent a relatively small fraction of total economic activity within the United States, accounting for 4.5 percent of all U.S.-business gross product in 1987, up from 2.5 percent in 1977. The comparable figure for manufacturing was 10.5 percent in 1987, up from 15.9 percent in 1977. In 1980, the evidence suggests, foreign direct investment foreign firms now have significant exposure to demand in the United States, very little data are available for foreign affiliates accounted for 4.1 percent of U.S. bank employment, and 8.5 percent of manufacturing employment.

In light of figures such as these, the proposition that foreign firms are important to national competitiveness as domestic firms is more a prediction of the future than a reflection of the present. In most areas—such as trade, output, employment, and R&D spending—domestic firms still dominate domestic economic activity.

And there are virtually no examples of U.S.-owned businesses. Proposition 2. "Where they are most like us, our policies have encouraged them to be so."

In certain sectors of the economy, however, foreign-owned firms represent a substantial share of domestic economic activity. Foreign companies now control roughly one-third of the U.S. chemical industry, one-third of the U.S. automobile industry, and one-sixth of the U.S. automobile industry.

Why have foreign firms gained such large shares of domestic production in these industries? Both U.S. and other multinationals invest abroad primarily to improve their shares of foreign markets. When protectionism trade barriers block access to markets, or even when barriers are only being discussed, foreign firms often respond by making direct investments in local production facilities. Protectionism is not a sufficient condition to explain foreign direct investment; foreign firms must be able to compete with domestic firms after incurring the higher costs of establishing local production to serve the domestic market. But protectionism may be a neces-
Trade friction is a major reason for the substantial foreign investment in America's electronics and automobile industries.

proprietary channels that limit the diffusion of technological knowledge to foreign competitors and users.

The Japanese companies, moreover, have substantial and growing shares in systems products, like computers and sophisticated telecommunications equipment. The markets for such products are also highly oligopolized, offering significant potential for the exercise of market power, and the Japanese companies are clearly focused on increasing their penetration into these markets at the expense of American and European producers.

One way for the Japanese companies to pursue this objective is to control the terms and availability of semiconductor supplies to American and European computer companies. There is compelling evidence that the Japanese firms used such techniques in 1987 and 1988, when the worldwide market for DRAMs was extremely tight. And more recent evidence indicates that many of the same Japanese firms have been trying to control the terms and availability of advanced display technologies—such as the liquid crystal displays used in laptop computers—to strengthen further their positions in computers and other products.

The practices employed by the Japanese firms to control the prices or deliveries of DRAMs or displays to foreign users are not necessarily illegal or unfair. Indeed, U.S. firms have often done the same when they had comparable market power in input industries. But when they reduce competition in important industries, such practices can be detrimental to the long-term interests of the U.S. and the world economy. Under these circumstances, American policies aimed at maintaining viable domestic producers as a counterweight to the Japanese may make sense as a kind of antitrust insurance.

Once we consider the effects of foreign direct investment on industry structure, the “who is us” debate becomes more complicated. It may be prudent, for example, for policy makers to prevent a merger or acquisition by a foreign firm that poses a significant competitive threat. Or it may make sense for policymakers to finance projects like Sonatech, that foster a more competitive supply base in a key input, even if such projects are not commercially viable, and to exclude foreign suppliers—in this case Japanese suppliers—if they exercise significant market power.

From this perspective, the U.S. should be using trade policy to open the Japanese semiconductor market to U.S. and other non-Japanese companies, including American affiliates operating in Japan. Semiconductors produced by Texas Instruments in Japan may promote more competition in the worldwide semiconductor industry than do semiconductors produced by Fujitsu in the United States. In that respect, we might legitimately favor an American company’s operations abroad over a foreign company’s operations in the U.S.

Proposition 4. “They are allowed to compete with us here, but we are not allowed to compete with them there.” Foreign operations that look like domestic operations in the U.S. economy may be treated differently in their home markets. For example, Motorola, a U.S. company with significant domestic operations, has needed the support of U.S. trade law to penetrate the Japanese market. But, obviously, no Japanese company would find it necessary to get U.S. government assistance to help sell products in Japan that were made in America. Non-Japanese firms have trouble selling to Japan, whether their operations are located in Japan or abroad, but Japanese firms have no trouble selling to Japan from either their domestic or foreign operations.

Japanese import trade is dominated by Japan’s own companies. In fact, shipments from Japanese subsidiaries abroad to their parent companies at home represent most of Japanese imports. In 1986, for example, intra-firm trade accounted for 72 percent of U.S. exports to Japan, compared to 68.5 percent of U.S. exports to Europe. In short, Japan’s import trade, as well as its export trade, is conducted to a distinctive degree by its own multinationals.

In addition, because of the control of distribution channels in Japan, foreign companies remain highly dependent on Japanese distributors for the sale of their products in Japan. If foreign goods compete directly with domestic products, they have trouble entering Japan. Imports that are complementary with the interests of domestic companies, on the other hand, get in easily. In both cases, corporate control over Japan’s trade rests in the hands of Japanese companies.

The same is certainly not the case in the United States. Japanese firms in America can easily distribute their products through their own channels, and most big Japanese firms do. Foreign direct investment in wholesale and retail trade in the U.S. is substantial, in fact, that by 1986 foreign affiliates accounted for 25 percent of total U.S. imports and nearly half of U.S. exports. So while Japanese firms control Japanese trade with the rest of the world, foreign firms dominate America’s trade.

The barriers to sales by foreign companies in Japan are another justification for American emphasis in its negotiations with Japan on market access for all foreign-owned companies, not just American ones. Trade negotiations between the U.S. and Japan on specific industries known as the MOSS (“market-oriented, sector-specific”) talks, the U.S.-Japan Semiconductor Trade Agreement, and the U.S.-Japan talks on beef, citrus, and more recently, rice imports, have all demanded market access for all foreign companies, including the affiliates of foreign companies inside Japan.

In Japan, as in most other parts of the world, a wide variety of factors may favor indigenous over American firms. Some of these factors involve discriminatory policies, the traditional market structure of trade disputes. Other factors involve policies or institutions that, even if not designed as barriers, effectively block access by American firms. Some examples are product standards and testing, laws regarding intellectual property rights, health and safety rules, and consumer product regulations.

In a world of deep and persistent structural differences among nations, competition is unlikely to be perfect—or perfectly fair. To contain the inevitable friction between nations and between global companies, the U.S. and other developed countries must achieve two goals. First, they must scale back policies and dismantle institutions that intentionally discriminate between domestic and foreign companies. Second, they must agree to harmonize structural differences that hurt foreign producers and to recognize the persistence of such differences and accept them as fact.

Achieving both goals is the best approach to freer and fairer world trade. But neither will be easily or quickly accomplished. In the meantime, what should the U.S. do when national policy differences “abut the playing field” against American producers? Should foreign firms be allowed to compete with us in the relatively open U.S. marketplace, while American firms are precluded from competing with them abroad? Should the American government treat foreign firms exactly like domestic firms in our home market even though foreign
governments are discriminating against American firms in their home markets?

The principles of branch-based reciprocity, most-favored-nation treatment, and national treatment on which U.S. policy has traditionally been based suggest affirmative answers to these questions. These principles imply three conditions: First, overall access to the U.S. market across a broad range of goods and services should be comparable to overall access to foreign markets (comparable access in particular products and with particular trading partners is not required). Second, whatever rights of access the U.S. accords to one of its trading partners should be accorded to all such partners. And third, all foreign-owned firms operating in the U.S., regardless of ownership, should be treated like domestically owned firms.

When American companies are discriminated against by particular foreign partners in particular industries, however, the principle of selective reciprocity may sometimes be a more appropriate guide to U.S. policy. According to this principle, access to the U.S. market by particular foreign firms through trade or investment should depend on comparable access of American firms to the home markets of these firms. Unlike the traditional approach, the selective reciprocity approach focuses on particular industries and trading partners. Selective reciprocity implies that foreign companies will not have access to the U.S. market unless their home countries provide U.S. companies comparable access. Under selective reciprocity there is no guarantee that a right of access accorded by the U.S. to a particular trading partner would be extended to all trading partners, nor is there any guarantee of national treatment. If a foreign country does not accord national treatment to an American company, selective reciprocity might lead U.S. policy makers to act reciprocally toward companies based in that country.

The selective reciprocity principle is a serious and dangerous departure from normal U.S. policy. A world in which market access arrangements were negotiated on a bilateral, sector-specific basis would be a world in which the benefits of broad-based reciprocity, most-favored-nation treatment, and national treatment would be lost. Selective reciprocity encourages preferential trading blocs, retaliation, and bilateral trade deals that carve up national markets to achieve "reciprocal" outcomes in particular industries. Consequently, selective reciprocity should be invoked sparingly and only under exceptional circumstances.

But reciprocity should be the principle behind U.S. policy when there is a long history of foreign restrictions on the sales and investments of U.S. companies, when there is clear evidence of promotional industrial targeting policies that have benefited foreign producers at the expense of American producers, and when the industry in question is particularly important to our future living standards. Under such circumstances, there should be no presumption against—and certainly no simple rule—that "they are us."

Proposition 5. "They are not us."

For purposes of national security, foreign companies may not be interchangeable with American companies even if they have negotiated national security in the classic, restricted military sense. Are foreign affiliates equivalent to domestically owned operations for such purposes?

In a global world economy, a sensible economic strategy for national defense should have these goals:

First, it should use requirements for national ownership, or local production by foreign suppliers, to enhance national control over suppliers regardless of their nationality.


Second, it should seek to stimulate a diversity of suppliers to maintain an honest or competitive supply base.

And, third, it should avoid condemning the nation to mediocre technologies and unnecessarily high costs in the process.

The U.S. cannot rely on a wholly owned U.S. industrial base for military purposes. Such a strategy is simply too expensive and keeps out foreign technology. Many military technologies are dual-use technologies in which U.S. companies no longer have the head-to-head positions or are no longer the low-cost, high-quality producers. Where foreign commercial technology essential to defense has a distinct lead, the U.S. should actively seek foreign investors and encourage them to invest in manufacturing and research facilities within the U.S.

To maintain a strong national defense, control of production is sometimes more important than ownership. What matters may not be the extent of our dependence on foreign suppliers for a critical technology but whether the dependence is concentrated on a few suppliers. In military technologies, an honest, competitive supply base is especially important. Consequently, defense-related activities should be subject to more stringent antitrust supervision than industries unrelated to defense, and this supervision should apply to domestic firms as well as to foreign firms.

If an activity deemed vital to the national defense is subject to excessive market control by foreign producers, we have a number of possible remedies. As Edward Graham and Paul Kraun suggest, we can, first, regulate licensing of the capability to provide the good or service to domestic producers; second, pass local-content requirements, including provisions that R&D capabilities be maintained in laboratories and plants within the U.S. and that their facilities employ American citizens; and, third, enact policies to promote the entry or deter the exit of U.S. suppliers.

When defense goods and technologies are involved, the assumption that foreign firms are "us" must be subject to careful scrutiny. And sometimes dual-use policies may be required to make them more like us or to protect and promote our domestically owned competitors.

U.S. national security law now, in fact, does distinguish between "them and us.

Under the Exon-Florio amendment, the president can block mergers, acquisitions, or takeovers of U.S. companies by foreign interests when those actions might threaten national security. All of the other advanced industrial countries have similar national security provisions in their laws on foreign investment. In the U.S., as elsewhere, such a provision may be misused as a protectionist device. But not to recognize legitimate security concerns posed by foreign takeovers would be a great mistake.

Us, Them, and National Economic Competitiveness

Unlike Reich, I read the evidence as proving a strong, continuing link between American companies and the viability of the U.S. economy. Who is us? American companies still are. And while foreign firms represent bigger shares of the domestic economy, especially in a few major industries, they are still not as important as American firms. They are not yet us, although they are beginning to bear a strong family resemblance. And for national defense purposes, they will never be just like us.

But although my assessment of the current situation differs from Reich's assesse-
ment, I do not disagree with him on the trend. Globalization is here to stay. Over time, U.S. companies are likely to send larger shares of their operations abroad, while foreign companies are likely to bring more of their economic activity here.

There is no evidence, however, to suggest that this trend is accelerating. Indeed, the most recent numbers suggest a slowdown of foreign direct investment. The surge of foreign investment into the U.S. during the 1980s may have been an aberration, encouraged by special factors such as restrictions on auto imports, the boom in mergers and acquisitions, and changes in the dollar’s value.

As I agree with Reich about the long-term trend, so I agree with him about what the overarching goal of U.S. policy should be. According to Reich, the goal should be American competitiveness, which he defines as the capacity of Americans to add value to the world economy and thereby gain a higher standard of living in the future without going into ever deeper debt. With this goal in mind, national economic policies should be formulated to make the U.S. an attractive production location for the high-productivity, high-wage, research-intensive activities of both domestic and foreign firms. Not surprisingly, Reich and I share a policy agenda that gives priority to enhancing the education and skills of the American workforce, to building America’s economic infrastructure, and to fostering research and development. The nation’s human capital, infrastructure, and research base are its most important immovable assets.

We also agree that as a general rule, the U.S. should continue to welcome foreign direct investment, which can bring technology, jobs, greater efficiency, and other benefits. Nonetheless, in some circumstances, these benefits carry attendant risks—in particular, the risk of a more concentrated industrial structure and a potential loss of competition or the risk of excessive dependence on foreign suppliers for national defense. It is prudent, therefore, to monitor foreign direct investment for antitrust and national security purposes, as other nations do.

It is also sensible to invoke the principle of reciprocity under some circumstances. If American firms are kept out of foreign markets by overt discriminatory trade or investment barriers, the U.S. may legitimately demand those barriers be reduced as the price for access to the American marketplace.

The judicious use of the reciprocity principle in U.S. negotiations with its trading partners in the second half of the 1980s has had some beneficial results. The U.S. has successfully used the reciprocity idea to get foreign governments to revise their treatment of intellectual property to conform to U.S. standards. The principle of reciprocity has also been behind U.S. efforts to reduce market access barriers in Japan in a variety of products, including telecommunications and supercomputers.

Reciprocity is also a useful principle in thinking about mergers and acquisitions. The advanced countries differ sharply in their rules regarding foreign acquisitions of domestic companies. At one extreme are the U.S. and Great Britain, where foreigners can make acquisitions easily. At the other extreme are Japan and Germany, where mergers and acquisitions are more limited, and dominated by domestic companies and domestic financial institutions. These differences are the result chiefly of structural patterns in financial markets, rather than overt discrimination. Consequently, reciprocity implies a gradual harmonization of financial institutions to make markets equally accessible. In the meantime, the U.S. should continue to contest overt barriers to foreign investment in bilateral negotiations.

The principle of reciprocity is also applicable to public support for research and development. As a general rule, the U.S. might want to make publicly funded R&D programs available on the same terms to any company regardless of national origin, provided the home country of a foreign company reciprocates. Foreign firms perceived to hold significant market power might be excluded from such programs on antitrust grounds, particularly where the objective of government funding is to stimulate a more competitive supply.

As companies become more footloose in their location decisions, policies to contain and technical knowledge within national boundaries become increasingly ineffective. And as foreign direct investment in U.S. high-technology industries grows, policies to restrict R&D support to domestic companies become increasingly outdated. For example, U.S. policies to support generic R&D related to high-definition television should be open to both domestic and foreign companies, as long as they agree to do the research here and similar programs in their home countries are open to U.S. firms. In high-definition TV, as in other high-technology pursuits, the U.S. cannot afford the price of relying on national champions and excluding foreign ones, especially those like Sony, Philips, and Thomson, that have substantial R&D facilities in the United States.

Nevertheless, America’s strength in high-technology industries still depends disproportionately on American firms, even those with large overseas operations that have contributed to the growing high-technology strength of America’s major trading partners. Moreover, America’s ability to compete with other nations for the investment and R&D activities of foreign multinationals depends in part on the health of its own multinationals. Foreign firms want to be near their healthy American competitors to key into their knowledge and the network of skilled people who carry that knowledge with them. The major attraction to foreign investors is the health of the domestic economy; that in turn depends on the health of domestic companies.

Engine Charlie Wilson may have been right for the 1950s, and Robert Reich may well be right for the next century. But, for now, we need to improve in a world that fits no ideal model.

Who Do We Think They Are?

Robert B. Reich

Ever since I argued in the Harvard Business Review last year that we should pay less attention to corporate nationalism and more attention to whether our nation’s workforce was gaining the skills and competencies it needed to compete, I’ve had the curious sense of being shored—quite against my will—to the conservative side of the older debate over American industrial policy. My first stab of this transmigration came when The Wall Street Journal praised me and my argument in its editorial pages. If this were not cause enough for alarm, I found myself the recipient of expressions of shock and outrage from several fellow industrial-policy travelers who accused me of abandoning the worthy cause. And, now to deepen my gloom, comes Laura Tyson.

Anyone wishing to probe my detailed views on all this has only to buy my upcoming book on the subject, The Work of Nations. (Under the circumstances, the editors of this journal surely have no objection to a little
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blatant book promotion.) But for now, to set
the record straight, I am as committed
as ever to the notion that the U.S. govern-
ment has a crucial role to play in the
nation's economic development. Yet I
no longer have great confidence in the
American-owned corporation as its
partner. American firms—especially firms
engaged in tradeable goods and services—
are rapidly becoming global entities with no
special relationship to the American economy.
Thus, the object of American industrial
policy should be to enhance the value that
American workers can add to the world en-
vironment, rather than to increase the profit-
ability or global market share of these errant
American-owned companies. There is a
trivial and growing difference between the
two.

In the earlier part of her rebuttal, Tyson
takes issue with my last point, argue-
ing that there isn't much difference between
the American work force and American
companies—at least for now. Having (she
assumes) disposed of this issue, she then
go on to argue why the U.S. government
should promote and defend the interests of the
nation in international commerce. As to these
latter points, I'm in complete agree-
ment—except that, in pursuing these initia-
tives, she still assumes that the interests of
American firms are good approximations
for the interests of Americans, and I don't.
In my view, American industrial
policy could not treat American
firms any differently than they treat other
global corporations.

"Us" is the American Worker in
Global Commerce

First, Tyson's assertion that corporate
nationality still matters a great deal: To
make her case, she shows that U.S. multina-
tionals have most of their assets, sales, and
employment in the United States. But this
fact is entirely tautological. Firms are defined
as U.S. multinationals precisely because they
have most of their assets, sales, and employ-
ment in the United States. Tyson's point that
a larger percentage of the assets, sales, and
employment of American "multinationals"
was in the United States in 1988 than in 1977
is misleading. During that period, a great
many American firms that had been entirely
domestic (and therefore not classified as
"multinationals") began to venture abroad—but cautiously.

Similarly, no one should be surprised by
Tyson's argument that domestic firms still
 dominate domestic economic activity—
relegating foreign firms to a small fraction
of the American economy. Since most of
what's made or serviced in the United
States is not traded in international com-
merce, there is no particular reason why
foreign-based corporations would have the
expertise or the interest to undertake these
activities—particularly when the foreign
corporations would have to compete with
Americans who live here. Few taxicab com-
panies, soft-drink bottlers, greeting card fac-
tories, or hairdressers are owned by foreign-
based corporations.

The globalization of the American
ecosystem is most evident—and
most important for our future
standard of living of Americans—in those
sectors of the economy that are tradeable
internationally, or, more precisely, where
the labor of Americans compete in global
commerce with the labor of others' national
work forces. Here Tyson reveals very little.
She acknowledges that foreign-owned
firms now control one-half of the United
States consumer electronics industry, one-
third of the American chemical industry,
and 20 percent of the U.S. automobile in-
dustry. She might have added: 70 percent of
the U.S. tire industry, and almost 50 percent
of the U.S. film and recording in-
dustry. And if "control" applies to any
foreign ownership in excess of 10 percent of
the outstanding shares of stock (as measured
by several federal government agen-
cies), foreign-owned firms now "control"
most segments of America's banking, steel,
machine tool, robotics, and telecommu-
nications industries. Clearly, by this measure,
foreign-owned firms have established a sig-
nificant presence in the United States.

What about American corporations as
they relate to the internationally tradeable
skills of Americans? One measure is how
much of the value of products sold by
American corporations around the world
actually derives from American workers.
The answer is low and less. In each of the
last three years foreign operations of
American-owned firms have accounted for
more than $2 trillion in sales—or roughly
times the total export of goods made in
the United States, and about seven to eight
times the value of the nation's recent trade
deficit. In fact, the trade deficit turns into a
net surplus when the foreign sales of
American-owned firms are included, com-
pared to the total purchases by Americans
of the products of foreign-owned firms.

American firms are making large profits
overseas, even as their American profits
wither. While profits earned by American
firms in the United States dropped by 19
percent in 1989, the overseas profits of
American-owned firms surged by 14 per-
cent. In the first half of 1990, the foreign
affiliates of American corporations accounted
for 43 percent of their parent's total profits. General Motors, Ford,
IBM, DEC, and Coca-Cola, among many
others, earned most of their 1990 profits
outside the United States. Largely for this
reason, the overseas capital spending of
American-owned firms has mushroomed—by 17 percent in 1990, on top of
13 percent in 1989, and 24 percent in 1989—
even as their capital investments in
America have slowed to under 7 percent a
year. The trend is clear. American firms aren't exactly abandoning America; it is
more accurate to say that they are joining
the world, and bringing their production
across many continents, as they become
truly global firms. It's the same with the
sitting of high value-added production—
research and development, sophisticated
design and manufacturing engineering,
complex fabrication. Tyson argues that U.S.
multinationals are still allocating most of
their R&D budgets to America. But she
acknowledges that the trend toward global
siting is gathering remarkable speed—
American firms increased their overseas
R&D spending by 33 percent between 1986
and 1988, compared with a 0 percent in-
crease in R&D spending back home.

Actually, all these data underscore the extent of global economic in-
tegration. Foreign citizens who
are on the payrolls of the far-flung
affiliates of American corporations contribute only a
small fraction of the total "foreign" value
added to these firms' products; the same
goes for Americans on the payrolls of
foreign firms. The greater share is added
through cross-border supply contracts,
licensing agreements, and joint ventures.
And a large and growing number of high-
paid professional workers within every
advanced nation are contracting with foreign-
owned firms—conveying their services
(legal, financial, research, engineering, adver-
sising, management consulting) directly
to the foreign company for a fee. These
tasks, performed by Americans and pur-
chased by foreign-owned corporations,
represent some of the most lucrative ways
in which Americans engage in global com-
merce. Here, as before, the key question is:
Who is hiring Americans to add what value
to world markets? How can this value be
increased? My point, which Tyson has
dismissed, is that the profitability and
world market share of American firms have
less and less to do with the answers.

Industrial Policy Lives

We need government willing to take an
active role in helping American workers
add more value to global markets. In fact,
my argument about the disengagement
of the American corporation from America
underscores this need. And if we can't count
on the American-owned corporation to
take special responsibility for improving
the competitiveness of the American work
force, then the job necessarily falls to
government. Tyson and I both want an ac-

By all means, let's keep pressure on Japan to open its markets to our goods. Our primary goal should not be to open Japan to the sales of American companies, but to open Japan's borders to the work products of Americans.

Tyson also complains that "It's allowed to compete with us here, but we are not allowed to compete with them there." Her ire is directed particularly at Japan, and I agree that Japan has been slow to open itself to global competition. By all means, let's keep the pressure on Japan to open its market to our goods, but in doing so let's be sure to define "us" correctly. Tyson is concerned about Japan's barriers to sales by American companies. I'm not. Our primary goal should not be to open Japan to the sales of American companies, but to open Japan's borders to the work products of Americans. Our trade representative in Washington has spent considerable time and energy of late trying to force Japan to accept cellular telephones and pagers made by Motorola (mostly in Kuala Lumpur) and to allow Toys "R" Us to sell its wares (mostly produced in Southeast Asia and Latin America). These priorities make no sense from the standpoint of the American work force.

How do we pry open foreign markets? Tyson argues for a system of "selective reciprocity" through which foreign firms in a particular industry would be barred from investing in America so long as American firms in that industry were barred from investing in the country where the foreign firm was based. This strategy might work if the goal is to enhance the profitability and global market share of American firms, but it may backfire if the goal is to improve the productivity of American workers. My goal is the latter. Thus, I don't want to bar foreign firms from operating in the United States—particularly if they'll spend more money training American workers than is spent by American firms in the same industry, pay American workers higher salaries, give them more job security, and ask for more productive than American firms do—even if the country where they have their worldwide headquarters prohibits American firms from investing there. Studies have shown that Japanese firms, in particular, fulfill all these criteria.

Tyson's analysis of the nation's security needs is unobjectionable—that is, until she starts fretting once again about the nationality of corporate ownership. It makes sense to diversify our sources of critical military supplies and technologies across many nations and firms, to subject defense contractors to more stringent antitrust supervision, and to require that certain critical R&D capabilities be maintained in laboratories and factories within the United States, employing American citizens. But why should American firms be subject to any less stringent requirements?

Tyson and I agree on many things. But we don't agree on the difference between global capital and national labor. Money is unpatriotic these days, investment dollars are speeding to wherever on earth they can get the highest return. People, however, are relatively immobile, and they belong to societies with particular cultures and histories and hopes. It is up to governments to represent people, to respond to their needs and fulfill their hopes—not to represent global money.
Who Is Us?

by Robert B. Reich

Across the United States, you can hear calls for us to revitalize our national competitiveness. But wait –

who is "us"? Is it IBM, Motorola, Whirlpool, and General Motors? Or is it Sony, Thomson, Philips, and Honda?

Consider two successful corporations:

- Corporation A is headquartered north of New York City. Most of its top managers are citizens of the United States. All of its directors are American citizens, and a majority of its shares are held by American investors. But most of Corporation A's employees are non-Americans. Indeed, the company undertakes much of its R&D and product design, and most of its complex manufacturing, outside the borders of the United States in Asia, Latin America, and Europe. Within the American market, an increasing amount of the company's product comes from its laboratories and factories abroad.

- Corporation B is headquartered abroad, in another industrialized nation. Most of its top managers and directors are citizens of that nation, and a majority of its shares are held by citizens of that nation. But most of Corporation B's employees are Americans. Indeed, Corporation B undertakes much of its R&D and new product design in the United States. And it does most of its manufacturing in the U.S. The company exports an increasing proportion of its American-based production, some of it even back to the nation where Corporation B is headquartered.

Now, who is "us"? Between these two corporations, which is the American corporation, which the foreign corporation? Which is more important to the economic future of the United States?

As the American economy becomes more globalized, examples of both Corporation A and B are increasing. At the same time, American concern for the competitiveness of the United States is increasing.
Typically, the assumed vehicle for improving the competitive performance of the United States is the American corporation—by which most people would mean Corporation A. But today, the competitiveness of American-owned corporations is no longer the same as American competitiveness. Indeed, American ownership of the corporation is profoundly less relevant to America’s economic future than the skills, training, and knowledge commanded by American workers—workers who are increasingly employed within the United States by foreign-owned corporations.

So who is US? The answer is, the American workforce, the American people, but not particularly the American corporation. The implications of this new answer are clear: if we hope to revitalize the competitive performance of the United States economy, we must invest in people, not in nationally defined corporations. We must open our borders to investors from around the world rather than favoring companies that may simply fly the U.S. flag. And government policies should promote human capital in this country rather than assuming that American corporations will invest on “our” behalf. The American corporation is simply no longer “us.”

**Global Companies**

American corporations have been abroad for years, even decades. So in one sense, the multinational identity of American companies is nothing new. What is new is that American-owned multinationals are beginning to employ large numbers of foreigners relative to their American workforces, are beginning to rely on foreign facilities to do many of their most technologically complex activities, and are beginning to export from their foreign facilities—including bringing products back to the United States.

Around the world, the numbers are already large—and still growing. Take IBM—often considered the thoroughbred of competitive American corporations. Forty percent of IBM’s world employees are foreign, and the percentage is increasing. IBM Japan boasts 18,000 Japanese employees and annual sales of more than $6 billion, making it one of Japan’s major exporters of computers.

Or consider Whirlpool. After cutting its American work force by 10% and buying Philips’s appliance business, Whirlpool now employs 43,500 people around the world in 45 countries—most of them non-Americans. Another example is Texas Instruments, which now does most of its research, development, design, and manufacturing in East Asia. TI employs over 5,000 people in Japan alone, making advanced semiconductors—almost half of which are exported, many of them back to the United States.

American corporations now employ 11% of the industrial work force of Northern Ireland, making everything from cigarettes to computer software, much of which comes back to the United States. More than 100,000 Singaporians work for more than 200 U.S. corporations, most of them fabricating and assembling electronic components for export to the United States. Singapore’s largest private employer is General Electric, which also accounts for a big share of that nation’s growing exports. Taiwan counts AT&T, RCA, and Texas Instruments among its largest exporters. In fact, more than one-third of Taiwan’s notorious trade surplus with the United States comes from U.S. corporations making or buying
things there, then selling or using them back in the United States. The same corporate sourcing practice accounts for a substantial share of the U.S. trade imbalance with Singapore, South Korea, and Mexico—raising a question as to whom complaints about trade imbalances should be directed.

The pattern is not confined to America's largest companies. Molex, a suburban Chicago maker of connectors used to link wires in cars and computer boards, with revenues of about $300 million in 1988, has 38 overseas factories, 5 in Japan. Loctite, a midsize company with sales in 1988 of $457 million, headquartered in Newington, Connecticut, makes and sells adhesives and sealants all over the world. It has 3,500 employees—only 1,200 of whom are Americans. These companies are just part of a much larger trend: according to a 1987 McKinsey & Company study, America's most profitable midsize companies increased their investments in overseas production at an annual rate of 20% between 1981 and 1986.

Overall, the evidence suggests that U.S. companies have not lost their competitive edge over the last 20 years—they've just moved their base of operations. In 1966, American-based multinationals accounted for about 17% of world exports; since then their share has remained almost unchanged. But over the same period, the share of exports from the United States in the world's total trade in manufactures fell from 16% to 14%. In other words, while Americans exported less, the overseas affiliates of U.S.-owned corporations exported more than enough to offset the drop.

The old trend of overseas capital investment is accelerating: U.S. companies increased foreign capital spending by 24% in 1988, 13% in 1989. But even more important, U.S. businesses are now putting substantial sums of money into foreign countries to do R&D work. According to National Science Foundation figures, American corporations increased their overseas R&D spending by 33% between 1986 and 1988, compared with a 6% increase in R&D spending in the United States. Since 1987, Eastman Kodak, W.R. Grace, Du Pont, Merck, and Upjohn have all opened new R&D facilities in Japan. At Du Pont's Yokohama laboratory, more than 180 Japanese scientists and technicians are working at developing new materials technologies. IBM's Tokyo Research Lab, tucked away behind the far side of the Imperial Palace in downtown Tokyo, houses a small army of Japanese engineers who are perfecting image-processing technology. Another IBM laboratory, the Kanagawa arm of its Yamato Development Laboratory, houses 1,500 researchers who are developing hardware and software. Nor does IBM confine its pioneering work to Japan; recently, two European researchers at IBM's Zurich laboratory announced major breakthroughs into superconductivity and microscopy—earning them both Nobel Prizes.

An even more dramatic development is the arrival of foreign corporations in the United States at a rapidly increasing pace. As recently as 1977, only about 3.5% of the value added and the employment of American manufacturing originated in companies controlled by foreign parents. By 1987, the number had grown to almost 8%. In just the last two years, with the faster pace of foreign acquisitions and investments, the figure is now almost 11%. Foreign-owned companies now employ 3 million Americans, roughly 10% of our manufacturing workers. In fact, in 1989, affiliates of foreign manufacturers created more jobs in the United States than American-owned manufacturing companies.

And these non-U.S. companies are vigorously exporting from the United States. Sony now exports audio- and videotapes to Europe from its Dothan, Alabama factory and ships audio recorders from its Fort Lauderdale, Florida plant. Sharp exports 100,000 microwave ovens a year from its factory in Memphis, Tennessee. Last year, Dutch-owned Philips Consumer Electronics Company exported 1,500 color televisions from its Greenville, Tennessee plant to Japan. Its 1990 target is 30,000 televisions; by 1991, it plans to export 50,000 sets. Toshiba America is sending projection televisions from its Wayne, New Jersey plant to Japan. And by the early 1990s, when Honda annually exports 50,000 cars to Japan from its Ohio production base, it will actually be making more cars in the United States than in Japan.

The New American Corporation

In an economy of increasing global investment, foreign-owned Corporation B, with its R&D and manufacturing presence in the United States and its reliance on American workers, is far more important to America's economic future than American-owned Corporation A, with its platoons of foreign workers. Corporation A may fly the American flag, but Corporation B invests in Americans. Increasingly, the competitiveness of American workers is a more important definition of "American competitive-
What kind of foreign-owned businesses really contribute to national competitiveness? Actually, there are four models to consider, each doing business at a different level of complexity and local intellectual content: importers, assemblers, plant complexes, and fully integrated business operations. For those complex discrete manufacturing businesses such as electronics and automobiles that are at the heart of trade concerns, it is only fully integrated operations that build the local skill base and infrastructure in ways that increase international competitiveness and consequently raise living standards. They do so by bringing in-country the essential engine of business competitiveness.

The Matsushita consumer electronics complex at Kadoma, Japan demonstrates the importance of a fully integrated operation. All four key intellectual elements of the television and videocassette recorder (VCR) product and production systems—product design, manufacturing, process engineering, and vendor management—take place there. Although many components are outsourced, these key intellectual elements are “insourced” at Kadoma so they can be tightly integrated and optimized. Matsushita even builds most of its manufacturing equipment. Mech decks, the highly complex head and tape transport assemblies for VCRs, are assembled by Matsushita robots. 

This tight integration enables Matsushita to raise quality, reduce labor hours, provide a high level of product variety to the market, and rapidly incorporate new technology into new products. The mech decks are designed so that every part can be assembled with a simple vertical motion, which facilitates 100% assembly automation and high process reliability. This “producible design,” which can only be accomplished when there is close teamwork among product designers, process designers, component vendors, and manufacturing managers, in part explains why Matsushita has been able to maintain a leading competitive position worldwide despite the yen shock.

Typical importing and assembly operations are at the opposite end of the scale. Importing companies limit local economic activity to sales, marketing, and distribution, their aim is to win local market share and broaden the business base for an engine of competitiveness located offshore. (We use the term “local” to mean activity carried out in the host country.) Assemblers, a category that includes the U.S. organizations of many Asian-owned consumer electronics companies, make products locally, using designs, processes, and management approaches developed in the home country. They may buy some components locally, but they are likely to import key components, and all the sourcing decisions are made in the home country. As a result, it is difficult for local companies to become suppliers, and the most important supply positions often go to local subsidiaries of home-country suppliers.

Plant complexes add a further level of value added and begin to add intellectual content. Typically, a complex will fabricate product components, and the amount of local engineering content increases. Examples in the United States include the Nissan complex in Smyrna, Tennessee, which makes its own transmissions and transaxels, and the Sony television complex in San Diego, California, which contributes 100% assembly automation and high process reliability. This “producible design,” which can only be accomplished when there is close teamwork among product designers, process designers, component vendors, and manufacturing managers, in part explains why Matsushita has been able to maintain a leading competitive position worldwide despite the yen shock.

But American investors also benefit from the successes of non-American companies in which Americans own a minority interest—just as foreign citizens benefit from the successes of American companies in which they own a minority interest, and such cross-ownership is on the increase as national restrictions on foreign ownership fall by the wayside. In 1989, cross-border equity investments by Americans, British, Japanese, and West Germans increased 20%, by value, over 1988.

The point is that in today’s global economy, the total return to Americans from their equity investments is not solely a matter of the success of particular companies in which Americans happen to have a controlling interest. The return depends on the total amount of American savings invested in global portfolios comprising both American and
Contribute to U.S. Competitiveness

makes its own tubes and (together with other Sony operations in California) has a significant engineering force. Still, a plant complex falls well short of a fully integrated business operation. The key intellectual elements of the product and production system are still in the home country, even if the distinctions are becoming more subtle. High-resolution tubes for computer monitors and jumbo television tubes that drive the product and process technology are made at Sony's lead plant in Inazawa, Japan. The U.S. plant makes more mature products.

Assembly operations and plant complexes (particularly the latter) look good on simple economic measures. They employ many assembly workers and some middle managers and engineers. They also can help with catch-up in weak areas of management skills: the GM-Toyota NUMMI plant in California, for example, has shown U.S. managers that management approach rather than automation accounts for much of the Japanese advantage in assembly productivity. These operations cannot bring the host country to the forefront of competitiveness, however, because the engine of competitiveness remains offshore. Thus they do not upgrade the local skill base and technology infrastructure to world leader status; they won't attract the best young managers and engineers; and they are unlikely to stimulate the creative work that spins off new businesses (the "Silicon Valley effect").

The real payoff from local operations for foreign-owned companies, then, comes in the form of fully integrated business operations—when product design, process design, manufacturing, and vendor management are co-located and tightly integrated in-country and the operation is set up to do business in the global market. In this fully integrated operation, the span of activities closely resembles similar operations in the home country.

Examples of fully integrated operations in the United States include the consumer electronics businesses of Philips and Thomson (which were built from acquired companies) and, increasingly, Honda's automobile business. These companies appear to have made commitments to devolve whole product lines to their U.S. subsidiaries. The new Honda Accord Coupe, for example, was designed and is made only in the United States and is exported in small quantities to Japan. Likewise, U.S. multinational companies have built many successful fully integrated operations in other parts of the world, for example, IBM's, TI's, and GE Plastic's operations in Japan, Hewlett-Packard's in Singapore, and Ford's in Europe.

The foreign-owned businesses that benefit national competitiveness most are those that commit their engine of competitiveness to the host country. When foreign-owned companies come only to win local market share, they add little to the host country's competitiveness. When they come to build a platform to compete in global markets, then they contribute to national competitiveness.

- Todd Hixon and Ranch Kimball

Todd Hixon is a vice president and high-tech practice leader with the Boston Consulting Group. Ranch Kimball, a manager with BCG, has worked extensively with consumer electronics and automotive companies. Both worked with the American Electronics Association in its high-definition television initiative.

foreign-owned companies—and on the care and wisdom with which American investors select such portfolios. Already Americans invest 10% of their portfolios in foreign securities; a recent study by Salomon Brothers predicts that it will be 15% in a few years. U.S. pension managers surveyed said that they predict 25% of their portfolios will be in foreign-owned companies within 10 years.

Control is less important. Another argument marshaled in favor of Corporation A might be that because Corporation A is controlled by Americans, it will act in the best interests of the United States. Corporation B, a foreign national, might not do so—indeed, it might act in the best interests of its nation of origin. The argument might go something like this: even if Corporation B is now hiring more Americans and giving them better jobs than Corporation A, we can’t be assured that it will continue to do so. It might bias its strategy to reduce American competitiveness; it might even suddenly withdraw its investment from the United States and leave us stranded.

But this argument makes a false assumption about American companies—namely, that they are in a position to put national interests ahead of company or shareholder interests. To the contrary: managers of American-owned companies who sacrificed profits for the sake of national goals would make themselves vulnerable to a takeover or liable for a breach of fiduciary responsibility to their shareholders. American managers are among the loudest in the world to declare that their job is to maximize shareholder returns—not to advance national goals.

Apart from wartime or other national emergencies, American-owned companies are under no spe-
cial obligation to serve national goals. Nor does our system alert American managers to the existence of such goals, impose on American managers unique requirements to meet them, offer special incentives to achieve them, or create measures to keep American managers accountable for accomplishing them. Were American managers knowingly to sacrifice profits for the sake of presumed national goals, they would be acting without authority on the basis of their own views of what such goals might be, and without accountability to shareholders or to the public.

Obviously, this does not preclude American-owned companies from displaying their good corporate citizenship or having a sense of social responsibility. Sensible managers recognize that acting "in the public interest" can boost the company's image; charitable or patriotic acts can be good business if they promote long-term profitability. But in this regard, American companies have no particular edge over foreign-owned companies doing business in the United States. In fact, there is every reason to believe that a foreign-owned company would be even more eager to demonstrate to the American public its good citizenship in America than would the average American company. The American subsidiaries of Hitachi, Matsushita, Siemens, Thomson, and many other foreign-owned companies lose no opportunity to contribute funds to American charities, sponsor community events, and support public libraries, universities, schools, and other institutions. (In 1988, for example, Japanese companies operating in the United States donated an estimated $200 million to American charities; by 1994, it is estimated that their contributions will total $1 billion.)

By the same token, American-owned businesses operating abroad feel a similar compulsion to act as good citizens in their host countries. They cannot afford to be seen as promoting American interests; otherwise they would jeopardize their relationships with foreign workers, consumers, and governments. Some of America's top managers have been quite explicit on this point. "IBM cannot be a net exporter from every nation in which it does business," said Jack Kuehler, IBM's new president. "We have to be a good citizen everywhere." Robert W. Galvin, chairman of Motorola, is even more blunt: should it become necessary for Motorola to close some of its factories, it would not close its Southeast Asian plants before it closed its American ones. "We need our Far Eastern customers," says Galvin, "and we cannot alienate the Malaysians. We must treat our employees all over the world equally." In fact, when it becomes necessary to reduce global capacity, we might expect American-owned businesses to slash more jobs in the United States than in Europe (where labor laws often prohibit precipitous layoffs) or in Japan (where national norms discourage it).

Just as empty is the concern that a foreign-owned company might leave the United States stranded by suddenly abandoning its U.S. operation. The typical argument suggests that a foreign-owned company might withdraw for either profit or foreign policy motives. But either way, the bricks and mortar would still be here. So would the equipment. So too would be the accumulated learning among American workers. Under such circumstances, capital from an-

A nation's most important competitive asset is the skills and learning of its work force.

other source would fill the void, an American (or other foreign) company would simply purchase the empty facilities. And most important, the American work force would remain, with the critical skills and capabilities, ready to go back to work.

After all, the American government and the American people maintain jurisdiction—political control—over assets within the United States. Unlike foreign assets held by American-owned companies that are subject to foreign political control and, occasionally, foreign expropriation, foreign-owned assets in the United States are secure against sudden changes in foreign governments' policies. This not only serves as an attraction for foreign capital looking for a secure haven; it also benefits the American work force.

Work force skills are critical. As every advanced economy becomes global, a nation's most important competitive asset becomes the skills and cumulative learning of its work force. Consequently, the most important issue with regard to global corporations is whether and to what extent they provide Americans with the training and experience that enable them to add greater value to the world economy. Whether the company happens to be headquartered in the United States or the United Kingdom is fundamentally unimportant. The company is a good "American" corporation if it equips its American work force to compete in the global economy.

Globalization, almost by definition, makes this true. Every factor of production other than work...
force skills can be duplicated anywhere around the world. Capital now sloshes freely across international boundaries, so much so that the cost of capital in different countries is rapidly converging. State-of-the-art factories can be erected anywhere. The latest technologies flow from computers in one nation, up to satellites parked in space, then back down to computers in another nation—all at the speed of electronic impulses. It is all fungible: capital, technology, raw materials, information—all, except for one thing, the most critical part, the one element that is unique about a nation: its work force.

In fact, because all of the other factors can move so easily any place on earth, a work force that is knowledgeable and skilled at doing complex things attracts foreign investment. The relationship forms a virtuous circle: well-trained workers attract global corporations, which invest and give the workers good jobs; the good jobs, in turn, generate additional training and experience. As skills move upward and experience accumulates, a nation's citizens add greater and greater value to the world—and command greater and greater compensation from the world, improving the country’s standard of living.

*Foreign-owned corporations help American workers add value.* When foreign-owned companies come to the United States, they frequently bring with them approaches to doing business that improve American productivity and allow American workers to add more value to the world economy. In fact, they come here primarily because they can be more productive in the United States than can other American rivals. It is not solely America’s mounting external indebtedness and relatively low dollar that account for the rising level of foreign investment in the United States. Actual growth of foreign investment in the United States dates from the mid-1970s rather than from the onset of the large current account deficit in 1982. Moreover, the two leading foreign investors in the United States are the British and the Dutch—not the Japanese and the West Germans, whose enormous surpluses are the counterparts of our current account deficit.

For example, after Japan’s Bridgestone tire company took over Firestone, productivity increased dramatically. The joint venture between Toyota and General Motors at Fremont, California is a similar story: Toyota’s managerial system took many of the same workers from what had been a deeply troubled GM plant and turned it into a model facility, with upgraded productivity and skill levels.

In case after case, foreign companies set up or buy up operations in the United States to utilize their corporate assets with the American work force. Foreign-owned businesses with better design capabilities, production techniques, or managerial skills are able to displace American companies on American soil precisely because those businesses are more productive. And in the process of supplanting the American company, the foreign-owned operation can transfer the superior know-how to its American work force—giving American workers the tools they need to be more productive, more skilled, and more competitive. Thus foreign companies create good jobs in the United States. In 1986 (the last date for which such data are available), the average American employee of a foreign-owned manufacturing company earned $32,887, while the average American employee of an American-owned manufacturer earned $28,954.

This process is precisely what happened in Europe in the 1950s and 1960s. Europeans publicly fretted about the invasion of American-owned multinationals and the onset of “the American challenge.” But the net result of these operations in Europe has been to make Europeans more productive, upgrade European skills, and thus enhance the standard of living of Europeans.

### Now Who Is Us?

American competitiveness can best be defined as the capacity of Americans to add value to the world economy and thereby gain a higher standard of living in the future without going into ever deeper debt. American competitiveness is not the profitability or market share of American-owned corporations. In fact, because the American-owned corporation is coming to have no special relationship with Americans, it makes no sense for Americans to entrust our national competitiveness to it. The interests of American-owned corporations may or may not coincide with those of the American people.

Does this mean that we should simply entrust our national competitiveness to any corporation that employs Americans, regardless of the nationality of corporate ownership? Not entirely. Some foreign-owned corporations are closely tied to their nation’s economic development—either through direct public ownership (for example, Airbus Industrie, a joint product of Britain, France, West Germany, and Spain, created to compete in the commercial airline industry) or through financial intermediaries within the nation that, in turn, are tied to central banks and ministries of finance (in particular the model used by many Korean and Japanese corporations). The primary goals of such corporations are to enhance the wealth of their nations, and the standard of living of their nations’ citizens, rather than to enrich their
shareholders. Thus, even though they might employ American citizens in their worldwide operations, they may employ fewer Americans—or give Americans lower value-added jobs—than they would if these corporations were intent simply on maximizing their own profits.  

On the other hand, it seems doubtful that we could ever shift the goals and orientations of American-owned corporations in this same direction—away from profit maximization and toward the development of the American work force. There is no reason to suppose that American managers and shareholders would accept new regulations and oversight mechanisms that forced them to sacrifice profits for the sake of building human capital in the United States. Nor is it clear that the American system of government would be capable of such detailed oversight.

The only practical answer lies in developing national policies that reward any global corporation that invests in the American work force. In a whole set of public policy areas, involving trade, publicly supported R&D, antitrust, foreign direct investment, and public and private investment, the overriding goal should be to induce global corporations to build human capital in America.

Trade policy. We should be less interested in opening foreign markets to American-owned companies (which may in fact be doing much of their production overseas) than in opening those markets to companies that employ Americans—even if they happen to be foreign-owned. But so far, American trade policy experts have focused on representing the interests of companies that happen to carry the American flag—without regard to where the actual production is being done. For example, the United States recently accused Japan of excluding Motorola from the lucrative Tokyo market for cellular telephones and hinted at retaliation. But Motorola designs and makes many of its cellular telephones in Kuala Lumpur, while most of the Americans who make cellular telephone equipment in the United States for export to Japan happen to work for Japanese-owned companies. Thus we are wasting our scarce political capital pushing foreign governments to reduce barriers to American-owned companies that are seeking to sell or produce in their market.

Once we acknowledge that foreign-owned Corporation B may offer more to American competitiveness than American-owned Corporation A, it is easy to design a preferable trade policy—one that accords more directly with our true national interests. The highest priority for American trade policy should be to discourage other governments from invoking domestic content rules—which have the effect of forcing global corporations, American and foreign-owned alike, to locate production facilities in those countries rather than in the United States.

The objection here to local content rules is not that they may jeopardize the competitiveness of American companies operating abroad. Rather, it is that these requirements, by their very nature, deprive the American work force of the opportunity to compete for jobs, and with those jobs, for valuable skills, knowledge, and experience. Take, for example, the recently promulgated European Community nonbinding rule on television-program production, which urges European television stations to devote a majority of their air time to programs made in Europe. Or consider the European allegations of Japanese dumping of office machines containing semiconductors, which has forced Japan to put at least 45% European content into machines sold in Europe (and thus fewer American-made semiconductor chips).

Obviously, U.S.-owned companies are already inside the EC producing both semiconductors and television programs. So if we were to adopt American-owned Corporation A as the model for America's competitive self-interest, our trade policy might simply ignore these EC initiatives. But through the lens of a trade policy focused on the American work force, it is clear how the EC thwarts the abilities of Americans to excel in semiconductor fabrication and filmmaking—two areas where our work force already enjoys a substantial competitive advantage.

Lack of access by American-owned corporations to foreign markets is, of course, a problem. But it only becomes a crucial problem for America to the extent that both American and foreign-owned companies must make products within the foreign market—products that they otherwise would have made in the United States. Protection that acts as a domestic content requirement skews investment away from the United States—and away from U.S. workers. Fighting against that should be among the highest priorities of U.S. trade policy.

Publicly supported R&D. Increased global competition, the high costs of research, the rapid rate of change in science and technology, the model of Japan's National policies should reward any global corporation that invests in the American work force.
with its government-supported commercial technology investments—all of these factors have combined to make this area particularly critical for thoughtful public policy. But there is no reason why preference should be given to American-owned companies. Dominated by our preoccupation with American-owned Corporation A, current public policy in this area limits U.S. government-funded research grants, guaranteed loans, or access to the fruits of U.S. government-funded research to American-owned companies. For example, membership in Sematech, the research consortium started two years ago with $100 billion annual support payments by the Department of Defense to help American corporations fabricate complex memory chips, is limited to American-owned companies. More recently, a government effort to create a consortium of companies to catapult the United States into the HDTV com-

Should Sony, Philips, and Thomson be eligible to participate in the HDTV consortium—with their American workers?

tition has drawn a narrow circle of eligibility, ruling out companies such as Sony, Philips, and Thomson that do R&D and production in the United States but are foreign-owned. More generally, long-standing regulations covering the more than 600 government laboratories and research centers that are spread around the United States ban all but American-owned companies from licensing inventions developed at these sites.

Of course, the problem with this policy approach is that it ignores the reality of global American corporations. Most U.S.-owned companies are quite happy to receive special advantages from the U.S. government—and then spread the technological benefits to their affiliates all over the world. As Sematech gets under way, its members are busily going global: Texas Instruments is building a new $250 million semiconductor fabrication plant in Taiwan; by 1992, the facility will produce four-megabit memory chips and custom-made, application-specific integrated circuits—some of the most advanced chips made anywhere. TI has also joined with Hitachi to design and produce a super chip that will store 16 million bits of data. Motorola, meanwhile, has paired with Toshiba to research and produce a similar generation of futurist chips. Not to be outdone, AT&T has a commitment to build a state-of-the-art chip-

making plant in Spain. So who will be making advanced chips in the United States? In June 1989, Japanese-owned NEC announced plans to build a $400 million facility in Rosedale, California for making four-megabit memory chips and other advanced devices not yet in production anywhere.

The same situation applies to HDTV Zenith Electronics is the only remaining American-owned television manufacturer, and thus the only one eligible for a government subsidy. Zenith employs 2,500 Americans. But there are over 15,000 Americans employed in the television industry who do not work for Zenith—undertaking R&D, engineering, and high-quality manufacturing. They work in the United States for foreign-owned companies: Sony, Philips, Thomson, and others (see the accompanying table). Of course, none of these companies is presently eligible to participate in the United States's HDTV consortium—nor are their American employees.

Again, if we follow the logic of Corporation B as the more “American” company, it suggests a straightforward principle for publicly supported R&D: we should be less interested in helping American-owned companies become technologically sophisticated than in helping Americans become technologically sophisticated. Government-financed help for research and development should be available to any corporation, regardless of the nationality of its owners, as long as the company undertakes the R&D in the United States—using American scientists, engineers, and technicians. To make the link more explicit, there could even be a relationship between the number of Americans involved in the R&D and the amount of government aid forthcoming. It is important to note that this kind of public-private bargain is far different from protectionist domestic content requirements. In this case, the government is participating with direct funding and thus can legitimately exact a quid pro quo from the private sector.

Antitrust policy. The Justice Department is now in the process of responding to the inevitability of globalization; it recognizes that North American market share alone means less and less in a global economy. Consequently, the Justice Department is about to relax antitrust policy—for American-owned companies only. American-owned companies that previously kept each other at arm’s length for fear of prompting an inquiry into whether they were colluding are now cozying up to one another. Current antitrust policy permits research joint ventures; the attorney general is on the verge of recommending that antitrust policy permit joint production agreements as well, when there may be significant economies of scale and where competition is global—again, among American-owned companies.
But here again, American policy seems myopic. We should be less interested in helping American-owned companies gain economies of scale in research, production, and other key areas, and more interested in helping corporations engaged in research or production within the United States achieve economies of scale—regardless of their nationality. U.S. antitrust policy should allow research or production joint ventures among any companies doing R&D or production within the United States, as long as they can meet three tests: they could not gain such scale efficiencies on their own, simply by enlarging their investment in the United States; such a combination of companies would allow higher levels of productivity within the United States; and the combination would not substantially diminish global competition. National origin should not be a factor.

*Foreign direct investment.* Foreign direct investment has been climbing dramatically in the United States: last year it reached $329 billion, exceeding total American investment abroad for the first time since World War I (but be careful with these figures, since investments are valued at cost and this substantially understates the worth of older investments). How should we respond to this influx of foreign capital?

Clearly, the choice between Corporation A and Corporation B has important implications. If we are most concerned about the viability of American-owned corporations, then we should put obstacles in the way of foreigners seeking to buy controlling shares in American-owned companies, or looking to build American production facilities that would compete with American-owned companies.

Indeed, current policies tilt in this direction. For example, under the so-called Exon-Florio Amendment of the Omnibus Trade and Competitiveness Act of 1988, foreign investors must get formal approval from the high-level Committee on Foreign Investments in the United States, comprising the heads of eight federal agencies and chaired by the secretary of the treasury, before they can purchase an American company. The expressed purpose of the law is to make sure that a careful check is done to keep "national security" industries from passing into the hands of foreigners. But the law does not define what "national security" means: thus it invites all sorts of potential delays and challenges. The actual effect is

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### U.S. TV Set Production, 1988

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Plant Type</th>
<th>Location</th>
<th>Employees</th>
<th>Annual Production</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bang &amp; Olufsen</td>
<td>Assembly</td>
<td>Compton, Calif.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Goldstar</td>
<td>Total *</td>
<td>Huntsville, Ala.</td>
<td>400</td>
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<tr>
<td>Harvey Industries</td>
<td>Assembly</td>
<td>Athens, Tex.</td>
<td>900</td>
<td>600,000</td>
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<tr>
<td>Hitachi</td>
<td>Total</td>
<td>Anaheim, Calif.</td>
<td>900</td>
<td>360,000</td>
</tr>
<tr>
<td>JVC</td>
<td>Total</td>
<td>Elmwood Park, N.J.</td>
<td>100</td>
<td>480,000</td>
</tr>
<tr>
<td>Matsushita</td>
<td>Assembly</td>
<td>Franklin Park, Ill.</td>
<td>800</td>
<td>1,000,000</td>
</tr>
<tr>
<td>American Kotobuki (Matsushita)</td>
<td>Assembly</td>
<td>Vancouver, Wash.</td>
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<td>n.a.</td>
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<td>Mitsubishi</td>
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<td>Assembly</td>
<td>McDonough, Ga.</td>
<td>400</td>
<td>240,000</td>
</tr>
<tr>
<td>Orion</td>
<td>Assembly</td>
<td>Princeton, Ind.</td>
<td>250</td>
<td>n.a.</td>
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<td>Philips</td>
<td>Total</td>
<td>Greeneville, Tenn.</td>
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<td>2,000,000+</td>
</tr>
<tr>
<td>Samsung</td>
<td>Total</td>
<td>Saddle Brook, N.J.</td>
<td>250</td>
<td>1,000,000</td>
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<tr>
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<td>Assembly</td>
<td>Forrest City, Ark.</td>
<td>400</td>
<td>1,000,000</td>
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<tr>
<td>Sharp</td>
<td>Assembly</td>
<td>Memphis, Tenn.</td>
<td>770</td>
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<td>Sony</td>
<td>Total</td>
<td>San Diego, Calif.</td>
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<td>1,000,000</td>
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<tr>
<td>Tatung</td>
<td>Assembly</td>
<td>Long Beach, Calif.</td>
<td>130</td>
<td>17,500</td>
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<td>Thomson</td>
<td>Total</td>
<td>Bloomington, Ind.</td>
<td>1,766</td>
<td>3,000,000+</td>
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<td>Components</td>
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<tr>
<td>Zenith</td>
<td>Total</td>
<td>Springfield, Mo.</td>
<td>2,500</td>
<td>n.a.</td>
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</tbody>
</table>

*Total manufacturing involves more than the assembling of knocked-down kits. Plants that manufacture just the television cabinets are not included in this list.ube* available.

Source: Electronic Industries Association, HDTV Information Center, Washington, D.C.
The federal government has been cutting back on the investments that are critical for America's competitive future.

Recently, Congress is becoming increasingly concerned about foreign takeovers of American airlines. A subcommittee of the House Commerce Committee has voted to give the Transportation Department authority to block foreign acquisitions. These policies make little sense—in fact, they are counterproductive. Our primary concern should be the training and development of the American work force, not the protection of the American-owned corporation. Thus we should encourage, not discourage, foreign direct investment. Experience shows that foreign-owned companies usually displace American-owned companies in just those industries where the foreign businesses are simply more productive. No wonder America's governors spend a lot of time and energy promoting their states to foreign investors and offer big subsidies to foreign companies to locate in their states, even if they compete head-on with existing American-owned businesses.

Public and private investment. The current obsession with the federal budget deficit obscures a final, crucial aspect of the choice between Corporation A and Corporation B. Conventional wisdom holds that government expenditures “crowd out” private investment, making it more difficult and costly for American-owned companies to get the capital they need. According to this logic, we may have to cut back on public expenditures in order to provide American-owned companies with the necessary capital to make investments in plant and equipment.

But the reverse may actually be the case—particularly if Corporation B is really more in America’s competitive interests than Corporation A. There are a number of reasons why this is true.

First, in the global economy, America's public expenditures don't reduce the amount of money left over for private investment in the United States. Today capital flows freely across national borders—including a disproportionately large inflow to the United States. Not only are foreign savings coming to the United States, but America's private savings are finding their way all over the world. Sometimes the vehicle is the far-flung operations of a global American-owned company, sometimes a company in which foreigners own a majority stake. But the old notion of national boundaries is becoming obsolete. Moreover, as I have stressed, it is a mistake to associate these foreign investments by American-owned companies with any result that improves the competitiveness of the United States. There is simply no necessary connection between the two.

There is, however, a connection between the kinds of investments that the public sector makes and the competitiveness of the American work force. Remember: a work force that is knowledgeable and skilled at doing complex things attracts foreign investment in good jobs, which in turn generates additional training and experience. A good infrastructure of transportation and communication makes a skilled work force even more attractive. The public sector often is in the best position to make these sorts of “pump priming” investments—in education, training and retraining, research and development, and in all of the infrastructure that moves people and goods and facilitates communication. These are the investments that distinguish one nation from another—they are the relatively nonmobilizable factors in the global competition. Ironically, we do not ordinarily think of these expenditures as investments; the federal budget fails to distinguish between a capital and an operating budget, and the national income accounts treat all government expenditures as consumption. But without doubt, these are precisely the investments that most directly affect our future capacity to compete.

During the 1980s, we allowed the level of these public investments either to remain stable or, in some cases, to decline. As America enters the 1990s, if we hope to launch a new campaign for American competitiveness, we must substantially increase public funding in the following areas:

- Government spending on commercial R&D. Current spending in this critical area has declined 95% from its level two decades ago. Even as late as 1980, it comprised .8% of gross national product; today it comprises only .4%—a much smaller percentage than in any other advanced economy.
- Government spending to upgrade and expand the nation's infrastructure. Public investment in critical highways, roads, bridges, ports, airports, and waterways dropped from 2.3% of GNP two decades ago to
1.3% in the 1980s. Thus many of our bridges are unsafe, and our highways are crumbling.

**Expenditures on public elementary and secondary education.** These have increased, to be sure. But in inflation-adjusted terms, per pupil spending has shown little gain. Between 1959 and 1971, spending per student grew at a brisk 4.7% in real terms—more than a full percentage point above the increase in the GNP—and teachers’ salaries increased almost 3% a year. But since then, growth has slowed. Worse, this has happened during an era when the demands on public education have significantly increased, due to the growing incidence of broken homes, unwed mothers, and a rising population of the poor. Teachers’ salaries, adjusted for inflation, are only a bit higher than they were in 1971. Despite the rhetoric, the federal government has all but retreated from the field of education. In fact, George Bush’s 1990 education budget is actually smaller than Ronald Reagan’s in 1989. States and municipalities, already staggering under the weight of social services that have been shifted onto them from the federal government, simply cannot carry this additional load. The result of this policy gap is a national education crisis: one out of five American 18-year-olds is illiterate, and in test after test, American schoolchildren rank at the bottom of international scores. Investing more money here may not be a cure-all—but money is at least necessary.

**College opportunity for all Americans.** Because of government cutbacks, many young people in the United States with enough talent to go to college cannot afford it. During the 1980s, college tuitions rose 26%, family incomes rose a scant 5%. Instead of filling the gap, the federal government created a vacuum: guaranteed student loans have fallen by 13% in real terms since 1980.

**Worker training and retraining.** Young people who cannot or do not wish to attend college need training for jobs that are becoming more complex. Older workers need retraining to keep up with the demands of a rapidly changing, technologically advanced workplace. But over the last eight years, federal investments in worker training have dropped by more than 50%.

These are the priorities of an American strategy for national competitiveness—a strategy based more on the value of human capital and less on the value of financial capital. The simple fact of American ownership has lost its relevance to America’s economic future. Corporations that invest in the United States, that build the value of the American work force, are more critical to our future standard of living than are American-owned corporations investing abroad. To attract and keep them, we need public investments that make America a good place for any global corporation seeking talented workers to set up shop.
USA

US Senator Calls for 'True Reciprocity' in US-China Trade and Diplomacy

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U.S. Senator Dan Sullivan on Monday called on both the American and Chinese governments to exercise “true reciprocity” in relations, including trade and diplomacy.

The Republican senator from Alaska, in a speech concerning Chinese outbound investment, and in an interview with VOA afterward, said China has been aggressively buying companies in key sectors such as robotics, biotech, advanced machineries, software, entertainment and media “throughout America and Western Europe. But if you’re an American firm, or a firm from Germany, and you want to go to China and buy Chinese companies in those same sectors, you would be told ‘no;’ you would be prohibited.”

Making “true reciprocity” US policy

Sullivan's proposed “true reciprocity” is rather simple and straightforward: “If Chinese companies want to invest in America’s biotech sector, then American companies should be able to invest in China’s biotech sector. It’s simple, it’s fair, it’s what China has said it wants to do but it doesn’t do, and we need to be much more serious about implementing it.”

Should China continue to ignore Washington’s calls for equal treatment and a level playing field, Sullivan says he is prepared to introduce legislation aiming at closing what he identifies as China’s “credibility gap,” and making sure that “true reciprocity” becomes official U.S. policy.

The Alaska Republican, who serves on both the Senate’s Commerce and Armed Services Committees, called on the U.S. government to reject “Middle Kingdom diplomatic practices” that fail to grant U.S. diplomats the same level of access Chinese diplomats receive in Washington.
“Middle kingdom” diplomatic practices

Quoting from a study done by the New York–based Asia Society, Sullivan said “for a number of years, the U.S. ambassador in Beijing was only getting deputy minister level access while we, of course, give higher access to Chinese ambassadors here in Washington.” He called the solution to such unequal diplomatic treatments “a no brainer.”

“If our ambassador in Beijing only gets deputy minister level access, then that’s what we should provide China’s ambassador in Washington, period. Middle Kingdom diplomatic practices should be firmly and aggressively rejected by the U.S. government everywhere,” Sullivan said.

He agreed that his proposed “true reciprocity” ought to also include issues such as granting journalists visas and access in both countries.

Growing domestic consensus

Sullivan said “there’s growing domestic consensus” in the United States that America’s strategic interests, including strategic economic interests, outweigh the market price of individual transactions, while acknowledging that each individual American businessman or woman naturally want the highest return for their individual product.

“The broader strategic interest of having a strong U.S. economy, and signaling to the next biggest economy in the world, China, that you need to play by the rules we play by, is also very important; and in my view, that importance strategically overrides the interest of the ability of American firms to sell to Chinese investment funds.”

Senator Dan Sullivan: China needs to play by rules we play by

Geo-economics

Daniel Twining, counselor and director of the Asia Program at the German Marshall Fund of the United States and an associate of the U.S. National
Intelligence Council, thinks the U.S. economic power so far has not been sufficiently utilized to advance the nation’s overall strategic, political and economic interests.

"The U.S. is used to this traditional foreign policy tool kit that involves the armed forces, the diplomatic corps and development (foreign aid), but there’s really a fourth link here, which is our economic statecraft,” he told VOA.

Twining said other major powers, including China, appear to be much more adept at what he called “geo-economics,” using trade and investment “quite actively” and “quite smartly” to advance overall national interests. “It may be smart for us to think more about our economic strategies in the world,” including acknowledging and adopting strategies accordingly based on the fact that “market forces are not working everywhere, including in an economy like China that is still somewhat closed or controlled in some respects.”

**Daniel Twining: Market forces are not working everywhere**

**Forgoing short-term profit**

A newly released report by Baker McKenzie put Chinese worldwide outbound investment at $200 billion in 2016, nearly half of which targeted assets in North America and Europe.

According to Robert Shapiro, chairman of Sonecon and former U.S. Undersecretary of Commerce for Economic Affairs, the primary goal of China’s overseas investments does not lie in short-term profit but rather in gaining strategic advantage, and that means not necessarily in gaining immediate economic return.

**Robert Shapiro: China playing the long game**