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FOREIGN INVESTMENT TREATIES: IMPACT ON DIRECT INVESTMENT

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Updated January 12, 1998

Abstract. As prospects grow for a new multilateral investment agreement, some groups within the United States are examining foreign investment agreements to determine their impact on the domestic economy. In particular, they are concerned that the current regime of bilateral investment treaties is negatively affecting domestic investment spending by U.S. firms, the U.S. international trade position, and the growth of domestic U.S. jobs.

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CRS Report for Congress

Foreign Investment Treaties: Impact on Direct Investment

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Foreign Investment Treaties: Impact on Direct Investment

Summary

Congress, through the Senate's constitutional responsibility to ratify treaties, plays a central role in U.S. negotiations on multilateral and bilateral investment treaties (BITs). Bilateral investment treaties are nation-to-nation agreements, which set out rules governing the mutual treatment of foreign investment. Since the early 1980s, the United States has used BITs as it main international negotiating vehicle to protect private U.S. investments abroad. This focus reflects U.S. frustration with international efforts by developed and developing economies to formulate a set of standards governing the treatment of foreign investment. A burst of foreign investment in the 1990s, however, spurred the developed economies to renew their efforts to forge an international set of standards on foreign investment in the form of a Multilateral Agreement on Investment (MAI). Such an agreement would aim to reduce the remaining obstacles to foreign investment, to stem the growth of investment subsidies being offered by many developing economies, and to protect developed nations' overseas investments.

As prospects grow for a new multilateral investment agreement, some groups within the United States are scrutinizing foreign investment agreements to determine their impact on the domestic economy. In particular, they are concerned that the current regime of bilateral investment treaties is negatively affecting domestic investment spending by U.S. firms, the U.S. international trade position, and the growth of domestic U.S. jobs. Since multilateral and bilateral investment treaties lower the risks involved for firms that invest abroad, some observers believe these treaties may encourage firms to invest more overseas, shifting jobs out of the United States and potentially lowering the firms' share of traditional investment spending done in the United States. Eventually, they argue, reduced levels of investment spending will lead to fewer jobs and lower incomes in the United States relative to economies abroad.

Analysis to date, however, indicates that foreign investment treaties, by themselves, have little, if any, influence on foreign investment spending as a whole. Instead, such treaties may alter the composition of overseas investing by influencing U.S. firms to increase their investment spending in some developing countries, particularly those with bilateral investment treaties, at the expense of other developing economies, but not likely at the expense of domestic investment spending. Additionally, recent analyses indicate that employment among foreign subsidiaries, especially among economically developing countries, is not a close substitute for employment in the United States. In most cases, investment spending abroad by U.S. multinational firms is due to favorable economic conditions. Investment treaties apparently shift employment demands within multinational firms among subsidiary operations in developing nations with similar levels of economic development and labor skills, but not necessarily at the expense of employment at the U.S.-based parent firms.

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Overview and Summary

Congress, through the Senate's constitutional responsibility to ratify treaties, plays an active role in developing and implementing the nation's policy on direct investment. Over the last two decades, part of this role involved ratifying bilateral investment treaties (BITs) as the United States and other developed economies relied predominantly on such BITs as negotiating tools. Generally speaking, BITs are nation-to-nation agreements, which set out rules governing the mutual treatment of foreign investment. The developed economies of the OECD (Organization for Economic Cooperation and Development) turned to BITs in the 1980s to protect their direct investments[1] abroad after their attempts to develop an international set of rules on foreign investment through international organizations either failed, stalled, or delivered meager results. In most cases, these efforts were rebuffed by a large number of developing countries, which viewed foreign investment with suspicion.

With capital in short supply in the 1990s, however, many developing economies dropped their opposition to foreign investment and started offering financial and tax subsidies to foreign firms willing to invest. This policy shift sparked a surge in direct investment abroad by the developed countries and a boom in the number of BITs. As the number of BITs multiplied, the United States and other OECD countries resolved to develop an international set of rules on foreign investment. Presently, the OECD countries are engaged in discussions over a proposed multilateral agreement on investment (MAI).[2] According to the Negotiating Group on the MAI, the MAI is expected to be much broader in scope than most BITs and, therefore, largely will replace the BITs in practice for relations between countries that join the MAI. Nevertheless, there may be specific provisions in individual BITs that are of value to investors. In such cases, the MAI would not prevent investors from maintaining those provisions.[3]

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[1] The United States defines direct investment abroad as the ownership or control, directly or indirectly, by one person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise. 15 CFR § 806.15 (a)(1).

[2] For additional information, see CRS Report 97-469, *Multilateral Agreement on Investment: Implications for the United States,* by James K. Jackson, updated October 7, 1997.

[3] Ley, Robert. The Scope of the MAI. Available at the OECD site on the Internet:
(continued...)

Regional trade agreements, such as the North American Free Trade Agreement (NAFTA), and the growth of the European Union have boosted the number of investment treaties. Moreover, the favorable treatment developed countries have accorded investment provisions in regional trade agreements and the growing number of bilateral investment treaties between developed and developing countries have encouraged the developed economies to push once again for a comprehensive international investment agreement. These efforts, however, concern some Americans who believe international investment treaties will raise U.S. firms' overseas investments at the expense of investments in the domestic U.S. economy, which they claim will negatively affect the long term rate of growth of the U.S. economy. In particular, some observers question whether such treaties stimulate growth in the overall level of direct investment internationally, assuming U.S. and overseas investments are substitutes, or whether they merely shift the composition of investment among countries, leaving the overall amount of foreign investment, as well as investment in the United States, unchanged.

Some Members of Congress and other observers also are scrutinizing foreign investment (both inward and outward) to determine the role it plays in the U.S. economy. Some of these observers view overseas investment as an expression of the strength of U.S.-style free market capitalism, while others believe it robs American workers of jobs and reduces workers' income while enriching corporate managers. Within Congress, some Members are challenging the policy of providing government-backed insurance for U.S. firms that invest abroad, because they view such insurance as "corporate welfare."[4] Others question the wisdom of engaging in another broad-based international treaty that will affect direct investment and trade flows until the economic effects of the North American Free Trade Agreement (NAFTA) are more clearly understood. Still other observers question the impact broad, regional treaties, such as the MAI, will have on the present regime of bilateral investment treaties.

Investment Agreements

The United States and other developed economies have sought through bilateral, multilateral, and regional agreements to achieve conformity across countries in the treatment of foreign investment. This goal is being pursued through the OECD, where developed countries are negotiating the Multilateral Agreement on Investment (MAI).

Multilateral and Regional Agreements

At the multilateral, or multi-nation, level, there are at least two major types of arrangements, or agreements, on foreign investment. One type of arrangement is an investment treaty that is part of broader set of treaties, which aims to integrate rules

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[3](...continued)
http://www.oecd.org/daf/cmis/mai/ley1.htm

[4] For additional information, see CRS Report 97-565, *OPIC: Employment and Other Economic Effects,* by James K. Jackson, May 23, 1997.

on foreign investment into a framework of rules geared toward economic cooperation and integration. Such arrangements include the treaties establishing the European Community and the North American Free Trade Agreement.

The second type of arrangement, such as the MAI currently being negotiated, covers only the issue of foreign investment. Of particular prominence among this group are the OECD Code of Liberalization of Capital Movements, the Code of Liberalization of Current Invisible Operations, and The Declaration on International Investment and Multinational Enterprises.[5] In 1961, the United States adopted the Code of Liberalization of Capital Movements and the Code of Liberalization of Current Invisible Operations.

The two OECD codes are legally binding on those OECD members who have voted to accept them[6], although there is no enforcement mechanism. As a result, the codes serve primarily to provide a framework of notification, examination, and consultation among the signatory countries. The code on liberalization and its companion code on current invisible operations are meant to promote the removal of restrictions on capital movements, including foreign investment, and to promote the repatriation of profits. The declaration on investment is not a legally binding treaty, but is a general statement of policy regarding foreign investment. Member countries are expected to accord multinational enterprises national treatment, or treatment that is no less favorable than that accorded to domestic investors, and to assure that this treatment is followed at the sub-national level. Generally, such agreements also grant most-favored-nation (MFN) status,[7] which also denotes an equality of treatment.

Bilateral Investment Treaties

Since multilateral arrangements on foreign investment lack enforcement provisions, the United States and other developed economies have felt it was necessary to look at other ways to protect their foreign investments. Encouraged by the success of European countries, which were negotiating bilateral treaties that dealt exclusively with foreign investment and with protecting those investments in a particular foreign country, the United States began fashioning its own bilateral investment treaties in the 1980s. These treaties require each party to extend MFN, or non-discriminatory, treatment and to observe national treatment with respect to both the admission and the subsequent treatment of foreign direct investment. Exceptions are made for industries or areas reserved for national security, or for other national objectives. As one lawyer wrote about this time period:

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[5] The members of the OECD adopted this Declaration on June 21, 1976, and updated it in 1979, 1984, and 1991.

[6] Jackson, John H., William J. Davey, and Alan O. Sykes, Jr. *Legal Problems of International Economic Relations: Cases, Materials and Text on the National and International Regulation of Transnational Economic Relations, Third Edition*. St. Paul, West Publishing Co., 1995. P. 275.

[7] See: CRS Issue Brief 93107, *Most-Favored-Nation Policy of the United States*, by Vladimir N. Pregelj.

> The impetus for this flurry of treaty-making activity over the last thirty years has been the strong drive by nationals and companies of certain states to undertake direct foreign investments in other countries and the consequent need to create a stable international legal framework to facilitate and protect those investments. These investors felt that relying on host country law alone subjected foreign investment capital to a variety of risks. Host countries may easily change the law after an investment is made, and host government officials responsible for applying local law may not always act impartially toward foreign investors and their enterprises. Moreover, investors and their home country governments believed that local law in some countries impeded the entry of foreign capital, treated foreign investments in an arbitrary and discriminatory manner, and imposed onerous conditions on the operation of privately owned foreign enterprises. These concerns proved to be more than theoretical, for the 1960s and 1970s witnessed numerous interferences by host governments with foreign investments in their territories.[8]

The United States began negotiating Bilateral Investment Treaties in 1982 after other forms of bilateral and multilateral arrangements proved too limited in removing barriers to foreign investment. By this time, developing countries had turned skeptical of the benefits of foreign investment and were reluctant to offer the types of guarantees the United States government was requesting through more encompassing agreements. Since 1982, the United States has signed 38 BITs, of which 27 are now in force. The other 11 await legislative action in the United States or in the other country, as indicated in **Table 1**.

Table 1. United States Bilateral Investment Treaties: Countries and Treaty Signature Date

Country	*Date*	*Country*	*Date*
Albania	1/10/95	Kyrgyzstan	1/19/93*
Argentina	11/4/91*	Latvia	1/13/95*
Armenia	9/23/92*	Moldova	4/21/93*
Azerbaijan	8/1/97*	Mongolia	10/6/94*
Bangladesh	3/12/86*	Morocco	7/22/85*
Belarus	1/15/94	Nicaragua	7/1/95
Bulgaria	9/23/92*	Panama	10/27/82*
Cameroon	2/26/86*	Poland	3/21/90*

continued

[8] Salacuse, Jeswald W. BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries. *International Lawyer*, Fall 1990. p. 659.

Table 1. United States Bilateral Investment Treaties - continued

Country	*Date*	*Country*	*Date*
Congo	2/12/90*	Romania	5/28/92*
Croatia	7/13/96	Russian Fed.	6/17/92
Czech Republ.	10/22/91	Senegal	12/6/83*
Ecuador	8/27/93	Slovakia	10/22/91*
Egypt	3/11/86*	Sri Lanka	9/20/91*
Estonia	4/19/94*	Trinidad/Tobago	9/26/94*
Georgia	3/7/94	Tunisia	5/15/90*
Grenada	5/2/86*	Turkey	12/3/85*
Haiti	12/13/83	Ukraine	3/4/94*
Honduras	7/1/95	Uzbekistan	12/16/94
Jamaica	2/4/94*	Zaire	8/3/84*
Kazakstan	5/19/92*		

* Indicates the Bilateral Investment Treaty has entered into force.

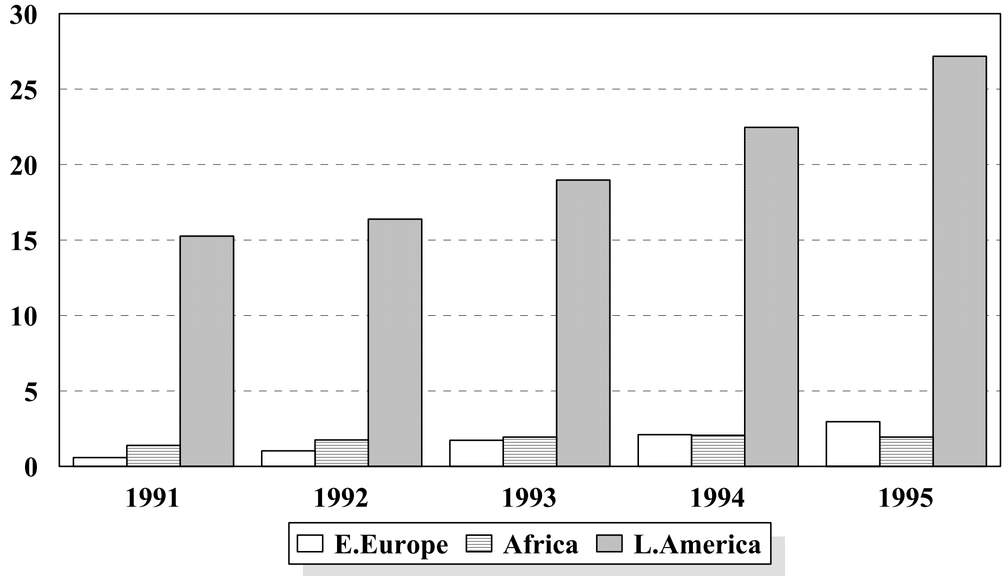
Source: Economic Perspectives. *USIA Electronic Journal*, Vol. 2, No. 2, April 1997. United States Information Agency, Washington, 1997. (http://usiahg/usis.usemb.se/journals)

One important factor behind the rush to form BITs was the explosion in overseas investment in the 1980s and 1990s by American, European, and Japanese firms. Between 1991 and 1995 alone, American direct investment in countries covered by a BIT nearly doubled, rising from $17 billion to $32 billion. This boost in investment spending compares well with total U.S. direct investment abroad, which increased by slightly less in percentage terms over the same period. As a result, U.S. investment in BIT countries increased from 3.7% to 4.6% of total U.S. direct investment abroad over the 1991-1995 period.

Bilateral Investment Treaties by Region

U.S. direct investment in BIT countries, however, has not been consistent across all countries. As **Figure 1** shows, the U.S. direct investment position, or the cumulative amount of U.S. direct investment, in Latin American BIT countries far exceeds similar investment in developing countries in other parts of the world. In terms of the rate of growth, however, U.S. direct investment in Latin America nearly doubled during the 1991-1995 period, a rate of growth that was slower than among other regional areas, but at about the same pace as the rate of growth of U.S. direct investment abroad as a whole. While a number of factors likely account for the growth in the U.S. direct investment position in Latin American BIT countries, the economic recovery of the region from the debt crises of the 1980s likely is the most important.

Figure 1. U.S. Direct Investment in Countries With Bilateral Investment Treaties, By Area: 1991-1995 (in billions of U.S. dollars)



Source: Survey of Current Business

In percentage terms, the largest growth in the U.S. direct investment position in BIT countries is in the economies of Eastern European countries. Since 1991, U.S. direct investment in these countries has increased five times from $600 million to $3 billion. During this same period, U.S. direct investment in Africa increased by one-third.[9]

Basic Provisions

While bilateral investment treaties can differ from one country to another, the United States seeks to include six basic guarantees in the treaties for American firms:

- Receive the better of national or most-favored-nation (MFN) treatment not only when they seek the initial investment, but throughout the life of the investment;

- Establish clear limits on the expropriation of investments and ensure that investors covered by the treaty will be fairly compensated. Expropriation can occur only for a public purpose, in a nondiscriminatory manner, under due process of law, and accompanied by payment of prompt, adequate, and effective compensation;

- Guarantee that investors have the right to transfer funds into and out of the country without delay using a market rate of exchange;

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[9] *Survey of Current Business,* September 1997. p. 144-145.

- Limit the ability of host governments to require investors to adopt such trade distorting practices as performance requirements;
- Establish the right to submit an investment dispute with the foreign government to international arbitration; and
- Give investors the right to engage the top managerial personnel of their choice regardless of nationality.[10]

Legal ambiguities abroad concerning the treatment of foreign investors also have prompted the United States to negotiate bilateral investment treaties as a means of protecting the foreign affiliates of American firms from arbitrary foreign government regulations and interference. In particular, the United States has negotiated BITs to protect U.S. firms from performance requirements imposed as conditions of investment establishment.[11] Performance requirements are market-distorting conditions imposed by a foreign government on non-domestic firms which attempt to establish new facilities, expand existing facilities, or even to maintain existing facilities. Prior to 1980, developing countries imposed performance requirements on foreign firms 60% of the time, according to a study by the Department of Commerce.[12] Recent studies by the United Nations indicate that most developing countries are liberalizing, or reducing, government restrictions that are applied specifically to foreign investors and that grant or withhold incentives or subsidies which discriminate against foreign investors.[13]

The wide spread movement toward greater openness regarding foreign investment has not progressed without impediments. A broad range of restrictions on foreign investment still exist at the national level. A report by the World Trade Organization (WTO) concludes:

> ...there are several qualifications to this liberalization trend. First, the trend has not been homogeneous and significant differences between foreign investment regimes persist. Second, virtually all countries maintain some restrictions, often of a sectoral nature, on the entry of foreign investment.[14]

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[10] *U.S. Bilateral Investment Treaty Program*. Available at the following site on the World Wide Web: usiahq.usis.se/journals/ites/0497/ej6fact4.htm

[11] Shenkin, Todd S. Trade-Related Investment Measures in Bilateral Investment Treaties and The GATT: Moving Toward a Multilateral Investment Treaty. *University of Pittsburgh Law Review*, Winter 1994. p. 579-582.

[12] Zakour, Charlotte A. *The Use of Investment Incentives and Performance Requirements by Foreign Governments*. The United States Department of Commerce, October 1981. p. 1-3.

[13] *World Investment Report, 1994: Transnational Corporations, Employment and the Workplace*. New York, United Nations, 1994. p. 278-312; *Incentives and Foreign Direct Investment*. New York, United Nations, April 1995.

[14] Trade and Foreign Direct Investment. *Annual Report 1996*. Geneva, World Trade Organization, 1996. p. 61-62.

A study by the United Nations concluded that no nation grants unrestricted access to all sectors and activities in its economy.[15] While generalizations are hard to make, the study determined that developed countries blocked access most often to natural resources sectors and to services sectors associated with national security, such as telecommunications, maritime, land and air transport, and media activities, as indicated in **Table 2**, which shows sectors that allow limited or reciprocal investment, or are closed to foreign investment.

Table 2. Investment Restrictions on Main Industries in Developed Countries, mid-1992

Country	*Bank-ing*	*Insur-ance*	*Radio*	*Tele-com.*	*Road trans.*	*Rail trans.*	*Air trans.*	*Marine trans.*
Australia	LR		L	L		C	L	
Austria	R	R	C	C	C	C	C	L
Belgium	R	R		L	C	C	L	L
Canada	LR	RL	L	L	C	C	L	L
Denmark	R	R	L	L	C	C	L	L
Finland	LR	R	C	L	R	C	L	L
France	LR	LR	L	L	R	C	L	L
Germany	LR		L	L	C	C	LR	L
Greece	LR	LR	C	C	C	C	C	L
Iceland	L	L	L	C		C	L	
Ireland	LR	LR		C			C	LR
Italy	LR	LR	C	C	C		LR	L
Japan	LR	L	L	L		L	L	L
Luxembourg			C	C	L	L	L	
Netherlands	LR	L	L	L	C	C	L	L
New Zealand			L	L		C	L	L
Norway	LR	LR	C	L	C	C	L	L
Portugal	LR	L	L	C		C	C	R
Spain	R	R	L	L		C	L	L
Sweden	L	L	L	C		C	L	L
Switzerland	R	L	L	C		C	L	L
Turkey	LR	LR	C	C		C	L	L
United Kingdom	R	R	L	L		C	L	L
United States	R	R	L	L		C	L	L

continued

[15] *World Investment Report,* 1994, p. 294.

Table 2 Investment Restrictions on Main Industries — continued

Country	*Min-ing*	*Oil and or gas*	*Fish-ing*	*Real estate*	*Tour-ism*	*Audio-visual*	*Pub-lish-ing*	*Pub-lic utili-ties*	*Gam-ing*
Australia	L	C	L	L	L	L	L	C	L
Austria	L	L	L	L	LR	L		L	C
Belgium		C	L		R			C	
Canada	L	L	L	L		L	L	L	
Denmark			L					C	
Finland	L		L					C	C
France	L	R	L		R	R	LR	L	L
Germany									C
Greece	L	C	L	L	R			C	C
Iceland		C	C	L	L			C	
Ireland			C					C	
Italy	R		L		R			C	C
Japan	C	C	L					L	
Luxembourg								C	
Netherlands			L					C	
New Zealand			L						
Norway			L		L			C	C
Portugal						L		C	
Spain				L				C	
Sweden									
Switzerland				L		C		L	
Turkey			L		L			C	
United Kingdom	L		L		L			C	
United States	L		L	R				L	

Source: *World Investment Report, 1994: Transnational Corporations, Employment and the Workplace*. New York, the United Nations, 1994. P. 295.

Note: L = Limited; R = Reciprocity; C = Closed.

In the developing countries, the major investment liberalizing activities have focused on export-oriented manufacturing industries, or projects involving advanced technology, according to the United Nations. Access to services industries is more available, although the United Nations determined that by 1992 such access had not reached the levels of openness generally found in the developed countries. Developing countries also are more prone toward using restrictions that affect the structure of control in foreign affiliates. Typically, such restrictions allow the host government to own or control a certain amount or a certain number of shares in the venture, control over appointing members on the board of directors, or the national composition of the management of the company.[16]

[16] World Investment Report, 1994, p. 300.

Recipient and investing countries may also have a very different set of objectives in mind when they negotiate a BIT. For developed economies, which dominate the sources of foreign investment, the major objective is to protect the foreign investments of their domestic firms. Most developing countries, however, negotiate a BIT to encourage, or even to promote, foreign investment, often in certain specified industries or sectors. Activities such as these, which are designed to channel foreign investment into specified could easily obscure the impact a BIT has on the foreign investment process.

Why Firms Invest Abroad

Most economic analyses indicate that multilateral or bilateral investment treaties have not had a measurable impact on firms' decisions to invest abroad. Such treaties, though, may affect the composition of a firms overseas investments. Firms weigh a broad range of issues, only one of which is a multilateral or bilateral investment treaty, before they commit their resources. After all, the challenges facing a firm that is operating a plant abroad, far from the home office, compound the everyday problems that arise in operating any business. Moreover, while it seems obvious that firms invest abroad to increase their profits, what is less obvious is which factors trigger the initial investment decision, or why firms choose to invest where they do in the first place, and what distinguishes multinational firms from those that remain purely domestic.[17]

Most economists believe that foreign direct investment offers positive benefits to both the investing and the recipient countries. These benefits include an increase in competition and consumers' choices and gains in productivity and efficiency. While such actions likely benefit or harm individual plants and localities differently, economic theory and a preponderance of studies indicate that they likely enhance the performance and long-term growth rate of the economy. Nevertheless, some Americans argue that the national gains attributed to investing overseas are offset by perceived local losses, which can include displaced U.S. workers and lost economic growth. A broad assortment of economic studies generally agree that investors consider a range of factors before they decide to invest abroad and that they have an array of options available to them which allows them to craft their investments in ways that suit their specific purposes and corporate requirements. For instance, firms can export to overseas markets instead of operating abroad, or they can arrange licensing agreements to lessen the burden of managing overseas subsidiaries. Firms can also establish joint ventures to take advantage of the experience of foreign firms, or they can invest directly by establishing a wholly owned subsidiary, acquire an existing facility, or be a minority partner with another foreign investor.

According to a number of economic analyses, the relative rates of economic growth between the United States and other foreign countries largely determine the

[17] For additional information, see: CRS Report 90-569, *Foreign Direct Investment: Why Companies Invest Abroad,* by James K. Jackson, December 7, 1990.

direction and magnitude of direct investment flows.[18] This means that changes in national economic growth rates can, and do, alter directly foreign investment flows from year to year. Historically, U.S. firms have been the most prolific overseas investors. A 1994 study by the United Nations[19] indicates that U.S. firms are the largest foreign direct investors in the world and own twice as much abroad as the Japanese or the British, the next largest foreign direct investors. By year end 1996, U.S. firms had accumulated, or had a position[20] of, $797 billion in overseas investments, based on historical cost,[21] or the book value of the investments.[22]

Firms that invest abroad are predominantly large, multinational corporations that possess economic strengths — managerial ability and technological leadership — that set them apart from their competitors. Such advantages are generally thought to be necessary to allow firms to overcome the disadvantages of operating in a foreign market — the additional costs associated with managing an enterprise from some distance, and added political and economic risks. While there are always exceptions, the largest share of U.S. direct[23] investment abroad is geared toward serving local foreign markets rather than toward shifting production abroad in order to reexport lower priced goods back to the United States. Such investments seem to be more profitable than exporting finished goods[24] to foreign markets for a number of reasons:

- They enable firms to avoid trade barriers by producing inside the country imposing the trade barrier;

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[18] For instance, see: Jackson, Sharon, and Stefan Markowski. The Attractiveness of Countries to Foreign Direct Investment: Implications for the Asia-Pacific Region. *Journal of World Trade*, October 1995. p. 159-179.

[19] *World Investment Report: Transnational Corporations, Employment and the Workplace*. New York, United Nations. 1994. p. 419-420.

[20] The position is the net book value of U.S. parent firms' equity in, and outstanding loans to, their foreign affiliates. It is distinguished from total assets, which are the sum of total owner's equity held by, and total liabilities owed to, both foreign investors and all other persons. A change in the position in a given year consists of three components: equity and intercompany outflows, reinvested earnings of affiliates, and valuation adjustments to account for changes in the value of financial assets. Whichard, Obie. Trends in U.S. Direct Investment Position Abroad, 1950-79. *Survey of Current Business*, February 1981. p. 39.

[21] In 1991, the Department of Commerce began publishing two alternative measures of direct investment: current cost and market value. Historical cost is used in this report instead of the other two measures because of the detailed country- and industry-level information that is available only on a historical cost basis. According to the current cost and market value measures, U.S. direct investment abroad reached $971 billion and $1,535 billion, respectively, in 1996. For additional information about the two alternative measures, see CRS Report 91-865, *Foreign Investments: How Much Are They Worth?*, by James K. Jackson, December 9, 1991.

[22] *Survey of Current Business,* September 1997, p. 128.

[23] See table 3.

[24] *International Direct Investment: Global Trends and the U.S. Role*. U.S. Department of Commerce. International Trade Administration. Washington, U.S. Govt. Print. Off., 1984. p. 3

- They improve the firm's ability to serve a foreign market through products designed specifically for, and manufactured in, the foreign market area, which allows for better relations with distributors and better service to customers;

- They provide for the defense of foreign markets from actual or potential competition;

- They lower the cost of the product for foreign markets through lower costs of production;

- They help firms accomplish international diversification of holdings and production capacity; and,

- They help firms react to host government policies which affect direct investments.

A range of factors also influence where U.S. firms choose to invest abroad. At the very least, the overseas investment decision is based on differences in national economic growth rates, exchange rate movements, productivity, wage levels, trade restraints, and overall corporate strategic business objectives, such as gaining access to markets, resources, or technology. Firms that have established operations abroad apparently consider a group of factors separate from those just listed when they decide to continue investing in existing facilities or to invest in new projects. Economic conditions abroad and in the United States may encourage firms to enlarge their existing overseas investment or to alter their year-to-year flows of capital between the parent firm and the foreign affiliates through reinvested earnings or intercompany account transfers to shift investment funds between the parent and the affiliate(s) depending on market conditions.

American direct investment abroad in 1996, or investment in businesses and real estate, increased slightly in nominal terms (not adjusted for inflation) over the amount invested in 1995.[25] In total, U.S. direct investment abroad in 1996 reached $86 billion, a 1.0% increase over the amount invested in 1995. In nominal terms, this is the largest amount U.S. firms have invested abroad during a one-year period. This direct investment abroad reflects reinvested earnings, which arise from the strong growth in the profits of the foreign affiliates of U.S. multinational firms. In 1995, American firms invested $85 billion abroad in nominal terms, also due to reinvested earnings and equity capital outflows from U.S. parent firms to their foreign affiliates, reflecting strong merger and acquisition activity abroad.[26]

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[25] CRS Report 97-328, *U.S. Direct Investment Abroad: The Pace of Growth Slows*, by James K. Jackson, updated September 29, 1997

[26] Bargas, Sylvia E.. Direct Investment Positions for 1996: Country and Industry Detail. *Survey of Current Business*, July 1997. p. 34-41.

Economic Effects

One of the most important economic issues that arise concerning BITs and other officially sponsored actions is how these actions affect the flows of spending on foreign direct investment. Whether intended or not, investment treaties may well promote foreign investment to a particular country, potentially at the expense of other countries without such a treaty, because investment treaties reduce some of the uncertainty firms face when they are investing abroad. While this and any number of other developments seem plausible, it has not been proven conclusively that investment treaties promote overseas investments overall above the levels that would have existed without such treaties. In most cases, economists contend that actions, such as an investment treaty, which reduce investors' risks tend to induce investors to shift their investments, in this case, from one country to another. Investments could be shifted among countries, or a change in the composition of investment spending, without this leading to a net increase in the overall level of foreign direct investment.

These and other complications further compound the problems analysts face in attempting to assess the impact investment treaties have on foreign direct investment. So far, analysts have not discovered a clear pattern from the available data that offers any indication of how investment treaties may affect the flow of investment funds to a particular country. This ambiguity arises in part from the fact that any number of factors could account for an increase in direct investment spending, including the national rate of economic growth. Also, a BIT may promote foreign investment by signaling foreign firms that the BIT signatory country has changed its policies and has become more receptive to foreign firms. As a group, the BIT signatory countries increased their share of U.S. direct investment funds by 27% over the 1991 to 1995 period. The U.S. direct investment position in the 38 BIT signatory countries reached $32 billion in 1995, accounting for 4.6% of the total U.S. direct investment position abroad, up from 3.6% in 1991, as indicated in **Table 3.**

Table 3. U. S. Direct Investment Abroad: Countries With Bilateral Investment Treaties (in millions of dollars)

	1991	1992	1993	1994	1995	1991	1992	1993	1994	1995
	Cumulative Position					*Annual Flows*				
All countries	467,844	502,063	564,283	621,044	711,62	32,696	42,647	77,247	53,078	93,406
BIT countries	17,249	19,183	22,809	26,913	32,477	1,135	1,744	2,989	3,407	4,485
Albania	0	0	0	6	4	0	0	0	18	-2
Argentina	2,831	3,327	4,442	5,945	7,962	367	558	1,079	1,419	2,107
Bangladesh	(D)	(D)	(D)	(D)	(D)	(D)	(D)	(D)	(D)	(D)
Belarus	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Bulgaria	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Cameroon	(D)	263	253	228	258	(D)	-52	10	-19	23
Congo	-13	(D)	(D)	226	(D)	-34	(D)	(D)	25	(D)
Croatia	NA	(*)	0	5	5	NA	0	0	4	1
Czech Republic	NA	NA	157	271	366	NA	NA	21	78	51
Ecuador	321	295	555	736	830	49	12	253	184	126
Egypt	1,246	1,334	1,510	1,412	1,409	-28	65	-32	-97	-24
Estonia	0	0	0	(D)	(D)	0	0	0	(D)	(D)
Georgia	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Grenada	1	2	2	3	3	(*)	(*)	1	(*)	(*)
Haiti	18	31	30	33	36	-16	10	3	3	1
Honduras	255	239	159	186	236	-2	-16	-51	40	56
Jamaica	763	892	1,049	1,259	1,400	144	137	173	253	146
Kazakhstan	(D)	(D)	(D)	(D)	(D)	(D)	(D)	(D)	(D)	(D)
Kyrgyzstan	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Latvia	0	0	0	(D)	(D)	0	0	0	(D)	(D)
Mongolia	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Morocco	57	77	81	90	111	8	7	19	6	12
Nicaragua	80	(D)	(D)	(D)	(D)	-32	(D)	(D)	(D)	(D)
Panama	10,484	11,038	12,043	13,538	15,900	527	677	668	948	1,006
Poland	32	191	427	545	787	29	178	195	118	232
Romania	8	16	25	49	49	8	9	17	28	3
Russia	NA	94	280	408	954	NA	19	222	142	525
Senegal	19	13	13	16	22	-1	-6	-2	5	1
Slovakia	NA	NA	(D)	(D)	(D)	NA	NA	(D)	(D)	(D)
Sri Lanka	7	9	10	14	13	1	1	1	3	-1
Trinidad and Tobago	510	565	691	771	813	-2	55	122	93	44
Tunisia	46	30	33	35	64	-37	-36	-13	8	-6
Turkey	545	732	995	1,079	1,167	144	134	279	140	163
Ukraine	NA	0	0	(D)	(D)	NA	0	0	(D)	(D)
Uzbekistan	NA	0	(D)	(D)	(D)	NA	0	(D)	(D)	(D)
Zaire	39	35	54	58	80	10	-8	24	8	21

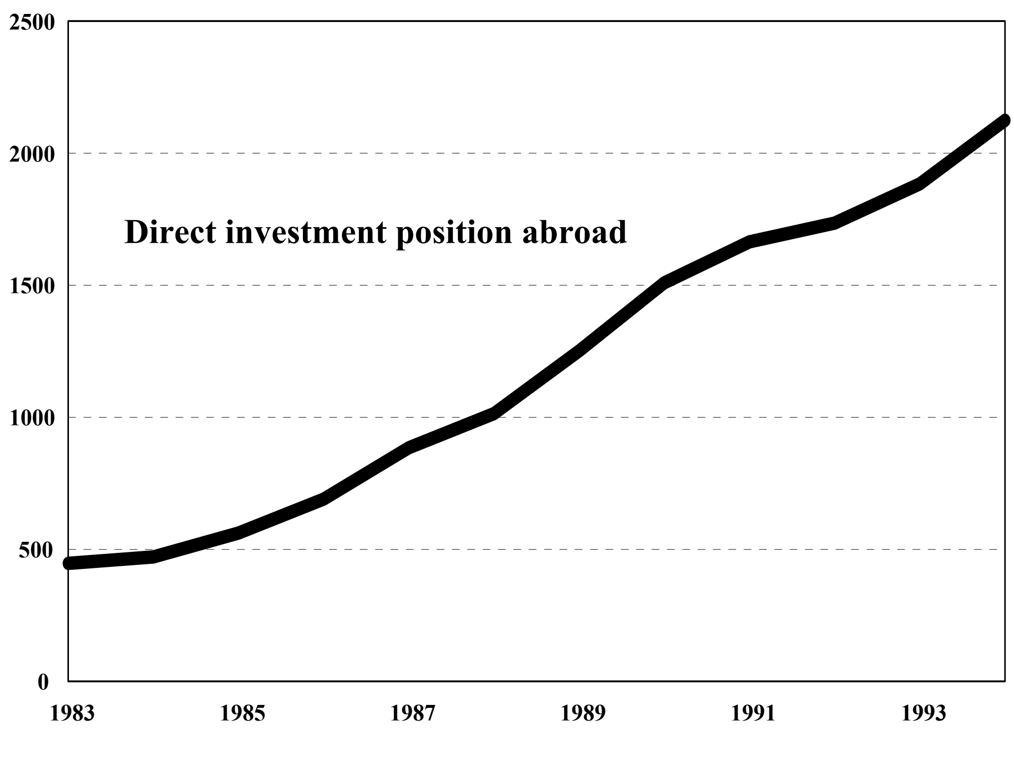
Note: A (D) indicates that data have been suppressed by the Department of Commerce to protect the identity of the individual investor; an asterisk (*) indicates values between -500,000 and 500,000.

Source: *Survey of Current Business*, September 1996. p. 124-125.

Since the early 1990s, the developed economies of the OECD have shown heightened interest in an international agreement on investment rules. Such interest likely stems from the rapid growth in overseas investment many developed economies experienced during the 1980s and 1990s. As **Figure 2** shows, foreign direct investment by the OECD countries more than quadrupled over the 1983-1994 period, rising from $447 billion in 1983 to $2.1 trillion in 1994.[27] This growth in foreign investment likely reflects the view of many firms that investing overseas is an essential component of their overall business strategy and that it is a complement to their export efforts. As one OECD official states:

> .... Although investments abroad by the largest firms are by no means a new phenomenon, a growing number of firms now view overseas expansion through direct investment as a necessity, with the aim often being to achieve more effective access in markets where the investor is presently under represented. In many cases these investments have the effect of leading to increased trade flows as

Figure 2. Direct Investment Position Abroad of OECD Countries, 1983-1994 (in billions of U.S. dollars)



Source: *Organization for Economic Cooperation and Development*

[27] *International Direct Investment Statistics Yearbook 1996.* Paris, Organization for Economic Cooperation and Development. 1996. Table 8, various countries.

well, demonstrating that investment and trade flows very often interact in a complementary manner.[28]

Economists have considered for some time the impact foreign direct investment has on the economies of the host and recipient countries and the conditions that spur firms to invest beyond their own national borders. There is little evidence to date that BITs, by themselves, influence firms' investment decisions. A study completed by the Multilateral Investment Guarantee Agency (MIGA)[29] concluded that a country's macroeconomic policies are the main factors that influence foreign investment flows, while such factors as BITs have almost no measurable impact on foreign direct investment flows.[30]

Foreign Investment and International Trade

One issue many in Congress and among the public share is concern over the ways U.S. direct investment abroad affects the Nation's trade performance and jobs situation. Such concerns were heightened during the debate over the North American Free Trade Agreement, or NAFTA. Some observers believe that liberalized trade and investment with developing economies, either through a bilateral investment treaty or a multilateral investment agreement, spurs a shift in manufacturing production from the United States with its higher paid American workers to developing countries with low-wage workers. Some critics argue that such a shift in production would worsen the U.S. trade deficit with developing economies, because U.S. multinational firms will substitute foreign-made goods for goods they previously had manufactured in the United States.

Contrary to these impressions, a broad range of economic analyses conclude that U.S. direct investment abroad, on the whole, helps sustain U.S. exports. Commerce Department data through 1993 indicate that American subsidiary firms operating abroad generally produced for the foreign local market. Invariably, some firms do invest abroad specifically to export low-priced goods back to the United States, but this is by no means the dominant, or even a substantial, practice. The largest share of the production of American foreign subsidiaries in 1993 was sold in the local market, with about 10% of world wide production shipped back to the United States, as **Table 4** indicates. BITs and multinational investment treaties likely affect the composition of foreign investment among countries, but exchange

[28] Witherell, William H. Developing International Rules For Foreign Investment: OECD's Multilateral Agreement on Investment. *Business Economics*, January, 1997. p. 33.

[29] The Multilateral Investment Guarantee Agency was created in 1988 as part of the World Bank Group to encourage the flow of foreign direct investment to its developing member countries for economic development. It accomplishes this goal by providing investment guarantees against the risks of currency transfer, expropriation, war, and civil disturbance.

[30] Shenkin, Todd S. Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty. *University of Pittsburgh Law Review*, Winter 1994. p. 577.

rates and national economic conditions likely set the overall pattern of foreign investment and trade.

Trade associated with the overseas investments of U.S. multinational firms grew smartly in nominal terms during the 1982-1994 period, but still plays a small role in the U.S. economy and in the activities of U.S. multinational firms. As **Figure 3** shows, intrafirm trade, or trade between a parent firm and its foreign subsidiaries, of U.S. parent companies has grown as a share of both U.S. exports and imports since 1990. [31] Despite the impressions these data may give that foreign investment spurs parent firms to increase their intrafirm imports, the data also indicate that exports from U.S. parent firms to their foreign subsidiaries outpaces imports from the subsidiaries both as a share of U.S. trade and in nominal terms. In 1994, the latest year for which data are available, U.S. intrafirm exports totaled $134 billion compared with intrafirm imports of $119 billion. Also, both intrafirm exports and imports appear to be growing generally in tandem, offering some support to those who contend that foreign investment and trade are complimentary, rather than substitute, economic activities.

Table 4. Sales by the Majority-Owned Overseas Affiliates of U.S. Parent Companies (in billions of U.S. dollars)

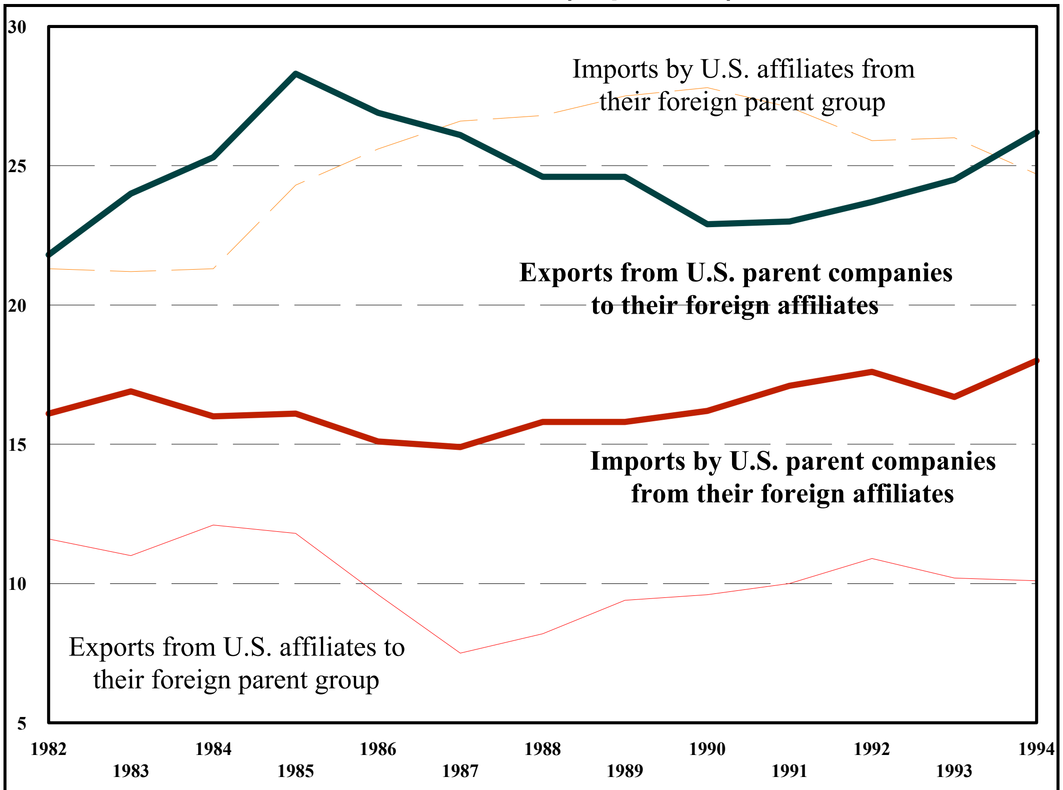
	1987	1988	1989	1990	1991	1992	1993	1994
All Affiliates								
Total Sales	815.5	927.9	1,020.0	1,208.3	1,242.6	1,291.6	1,276.0	1,432.4
Sales to the U.S.	88.9	101.4	114.7	123.9	125.5	129.2	136.7	150.1
Sales in local market	539.4	606.3	690.5	809.5	824.5	856.7	837.7	958.4
Sales to other foreign countries	187.2	220.1	214.7	275.0	292.6	305.7	301.4	323.9

Source: *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates*, various issues. U.S. Department of Commerce. Bureau of Economic Analysis. Washington, U.S. Govt. Print. Off.

While intrafirm trade among U.S. parent firms and their foreign affiliates appears to be growing as a share of U.S. exports and imports, similar trade among the U.S. affiliates of foreign firms and their foreign parents is declining. **Figure 3** (page 18) shows that imports by the U.S. affiliates from their foreign parent firms increased sharply in the 1980s as foreign investors poured billions of dollars into the U.S. economy to establish new businesses and to acquire existing U.S. businesses. During the 1990s, however, imports by the U.S. affiliates has trailed off by 13% as a share of U.S. trade, while exports from these affiliates has shown little growth as

[31] Zeile, William J. U.S. Intrafirm Trade in Goods. *Survey of Current Business*, February 1997. P. 24-29.

Figure 3. Shares of U.S. Exports and Imports Accounted for by Intrafirm Trade (in percent)



Source: *Survey of Current Business*

a share of U.S. trade since 1990, after growing by 45% between 1987 and 1992.[32] By 1994, such exports accounted for 10% of U.S. trade.

Foreign Direct Investment and the U.S. Economy

Although the U.S.-based parent firms still comprise the largest share of economic activity among U.S. multinational corporations (MNC), they have lost shares both within the MNC and within the U.S. economy. Recent data indicate that the foreign affiliates of U.S. parent firms increased their share of economic activity within the whole multinational enterprise relative to that of the parent firm during the 1977-1995 period, when total U.S. direct investment abroad, or the U.S. direct investment position, grew more than four times, from $146 billion to $797 billion. During this same time period, the foreign affiliates' share of total economic activity within U.S. multinational corporations (MNCs), or their share of the combined economic output of the U.S. parent and the foreign affiliates, increased by 13 %, rising from 22% to 25%[33] of the firms' total economic activity.

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[32] Ibid., p. 27.

[33] Mataloni, Raymond J., Jr., and Mahnaz Fahim-Nader. Operations of U.S. Multinational Companies: Preliminary Results From the 1994 Benchmark Survey. *Survey*
(continued...)

More significantly, the parent firms of U.S. multinational corporations, which are predominantly manufacturing firms, lost market positions at home during the 1980s due in large part to the downsizing efforts of corporations as they sought to improve their profits. The parent companies' share of all U.S. business gross domestic product (GDP), the broadest measure of total domestic economic activity, declined from 32% in 1977 to 26% in 1989, where the share has remained constant. The U.S.-based parent firms increased their shares of all private U.S. business GDP in the petroleum industries, but they lost shares in the manufacturing sector at the same time as the U.S. manufacturing sector declined from 30% of total private U.S. business GDP in 1977 to 24% in 1989, where the share has remained constant through 1994, according to the latest data.[34]

The relationship between overseas investment and domestic employment, however, is less clear. There is no conclusive evidence that U.S.-based parent firms shifted parts of their operations abroad specifically to reduce domestic employment by replacing domestic production with imports. Indeed, given the tight U.S. labor markets during much of the 1990s, some firms may have shifted operations abroad in search of available labor. Commerce Department data indicate that imports have doubled as a share of the output[35] of U.S. multinational corporations between 1982 and 1995, as indicated in **Table 4** (page 20), but imports from foreign affiliates still account for only 3% of the total output of U.S. MNCs (the combined output of the U.S. parents and the foreign affiliates). During the same period, local, or domestic, content of U.S. MNC output fell 1%, from 95% to 94%.

In addition, employment among U.S. MNCs does not indicate a significant shift of jobs, on the whole, from the U.S. parent firms to the offshore affiliates. This lack of statistical support persists despite changes in the shares of economic activity between parent firms and overseas affiliates, the relative decline of the domestic manufacturing sector, and the rise in imports as a share of MNC output. Employment at home and worldwide among U.S. MNCs over the 1982-1995 period increased slightly, reflecting the corporate downsizing of many large U.S. parent firms, which held down employment gains during much of the period. Employment data also indicate that U.S. parent firms and their foreign affiliates lost or gained employment in roughly the same industries.[36]

Recent analyses by several economists indicate that foreign subsidiary employment in developing economies is not a substitute for employment at the U.S.-based parent firm, but is a complement. Under these circumstances, employment in both the parent and the subsidiary firms moves in the same direction. Employment among foreign subsidiaries in developing countries, however, appears to be a

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[33](...continued)
of Current Business, December 1996. P. 24.

[34] Mataloni, Raymond J., Jr. U.S. Multinational Companies: Operations in 1995. *Survey of Current Business*, October 1997. P. 52.

[35] The output of U.S. MNCs reflects both gross product originating within the MNCs (both U.S. parents and foreign affiliates) and gross product that originates elsewhere and is embodied in intermediate inputs purchased from outside suppliers. Ibid., p. 48.

[36] Ibid, P. 47.

substitute for employment in countries with similar types of economies and skill levels.[37]

Table 4 Origin of Output of U.S. Multinational Firms by Industry, 1982 and 1995 (in percent)

	1982				1995			
	Share of total output accounted for by:				*Share of total output accounted for by:*			
	U.S. parent gross product	Imports of goods from foreign affiliates	Pur-chases from outside MNC	Local content	U.S. parent gross product	Imports of goods from foreign affiliates	Pur-chases from outside MNC	Local content
All Indust.	34	2	64	95	32	3	65	94
Petroleum	24	2	74	91	29	2	69	90
Manufact.	42	2	56	96	35	5	60	92
Food	30	1	69	97	31	1	67	97
Chem.	39	1	60	97	38	2	60	94
Metals	38	1	61	97	34	2	64	95
Ind. mach.	53	2	45	97	30	11	59	85
Elect.	47	3	50	94	34	5	61	88
Trans.	39	7	54	92	34	11	55	88
Other	45	1	54	97	40	2	58	96
Wholesale	11	1	89	93	11	1	88	86
Finance	12	*	D	D	11	*	D	D
Services	56	*	D	D	50	*	D	D
Other	46	1	54	99	41	1	58	98

Source: Mataloni, Raymond J., Jr. U.S. Multinational Companies: Operations in 1995. *Survey of Current Business*, October 1997, p. 49.

Conclusions

Despite the proliferation of bilateral investment treaties since the early 1980s, there is little empirical evidence to date which offers conclusive evidence that such treaties, by themselves, have a measurable impact on U.S. direct investment abroad or on U.S. domestic business investment spending and employment. Concerns persist among some groups, however, that bilateral investment treaties, or a new multilateral investment agreement, could provide a strong impetus for U.S. firms to shift major parts of their operations or employment abroad. No doubt, investment treaties may influence some firms in some states or cities to shift parts of their operations abroad, but the preponderance of analyses to date indicate that the overall

[37] Riker, David A., and S. Lael Brainard. *U.S. Multinationals and Competition From Low Wage Countries*. NBER Working Paper 5959, National Bureau of Economic Research, Cambridge, Ma. P. 18-20.

effects of inward and outward direct investment on the U.S. economy are positive. This dichotomy between public concerns and empirical evidence may well stem from the fact that the empirical evidence is generally not well known outside a relatively small group of analysts and the public has arrived at some conclusions on its own based on local, rather than on economy-wide, effects.

Indeed, at the local level, overseas investments by U.S. firms may well affect jobs at a particular location or plant, upsetting communities dependent on such jobs. For the U.S. economy as a whole, however, such job shifting ultimately will improve workers' jobs and incomes, as well as other economic choices. In an economy, such as the U.S. economy, that has operated for some time at full employment beyond the levels economists once thought of as the outmost limits, some firms may well search overseas for workers not easily recruited at home. The range of factors firms consider when they look overseas to invest is broad enough to encompass almost any possibility, but the existence of investment treaties does not seem to rank very high on the list.

A new multilateral agreement on investment will not necessarily replace all of the existing bilateral investment agreements. Depending on how the MAI negotiations proceed, the bilateral treaties may, in fact, be preferred to a multilateral agreement that has jettisoned many of the provisions desired by the United States, because the provisions proved to be too divisive on a multilateral basis. Regardless of the form of any final multilateral agreement, bilateral and multilateral investment treaties have not been shown to be major forces propelling U.S. direct investment abroad. Such investment treaties, however, do reduce the risks for firms looking to invest abroad and likely would be one factor that could encourage them to do so. Under these circumstances, investment treaties likely alter the composition of direct investment spending flowing to developing countries, particularly among those with similar levels of economic development or similar levels of labor force skills.