Commerical Law: The Foreign Direct Investment Regulations - A Solution to the United States Balance of Payments Crisis

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Ignorance, as much as self-interest, has dictated much of the United States' economic policies in the past several decades. Often it has been a case of policies adopted too late or in too little quantity or worse the right policy at the wrong time or extremes which are safe but do not correct.¹

This article shall critically examine the Foreign Direct Investment Regulations (FDIR) of the United States. It is this author's belief that an analysis of these regulations, their background and purposes, offers insight into an understanding of economic policies of the United States Government in regard to the world economic situation. This belief is buttressed upon the necessity of recognizing a reciprocal relationship between the United States economy and the world economy, that is the effect of the economy of the United States upon those of foreign states and the effect of the economies of foreign states upon that of the United States. Thus, the FDIR, though a product of the economic policies of the United States, are bound up in an economic situation in which every state of the world, including the United States, is but one participant.

On January 1, 1968, President Johnson, by executive order, put into effect mandatory controls on United States private direct investment.² These controls are referred to as the FDIR. Acting pursuant to section 5(b) of the 1917 Trading with the Enemy Act,³ the President delegated to the Secretary of Commerce the authority to administer the controls. The Secretary of Commerce then announced the creation of the Office of Foreign Direct Investments (OFDI) and delegated to it the authority to administer the Foreign Direct Investment Program.⁴

I. The Balance of Payments Deficit—Its Meaning and Significance

The Foreign Direct Investment Program was designed as a
response to a crisis, and thus the question of its permanency appears to be dependent upon the elimination of that crisis. The crisis was that the United States had recorded deficits in its balance of payments accounts for seventeen of the eighteen years in the period 1950-1967. And the crisis has continued in each subsequent year since the introduction of the mandatory controls.

The significance of a balance of payments deficit will be lost unless its essentials are first understood.

In the simplest terms, a nation incurs a balance of payments deficit whenever more units are paid out than are returned. Under the "liquidity" concept presently used by the United States Department of Commerce, the definition of "balance" is not, however, merely a matter of applying accounting techniques to all transactions involving foreigners. An analysis of the nature and purpose of the transaction must be made, and only those transactions that are "regular" are included in the balance computation. Within this definitional framework income from United States investments abroad, foreign investments in the United States, and return on United States exports are the regular transactions that have a positive impact on the payments account, and governmental spending abroad, private foreign investment, and payments for foreign imports are the deficit transactions.5

Under both of the official measurements of the United States balance of payments—the liquidity basis and the official settlements basis6—the resulting surplus or deficit reflects changes in United States official reserve assets, a deficit resulting in a drain on the United States reserve position. But a key fact, which the measurements of the United States balance of payments do not reflect, is that United States total foreign assets greatly exceeded liabilities and thus "[t]he problem [is] then not one of solvency, but of the country's liquidity or cash position."7

5. Young, Governmental Regulation of Foreign Investment, 47 Texas L. Rev. 421, 421-22 (1969) (footnote omitted).

6. The official settlements balance considers changes in the dollar claims of foreign monetary authorities and reserve losses of the United States, but excludes private transactions, thus reflecting only transactions between governments. But the liquidity computation of the balance of payments treats increases in "liquid" liabilities to foreigners as financing or settling the overall deficit—i.e., short-term foreign debts of the United States are included while short-term claims owed to the United States are not.

As a member of the International Monetary Fund (IMF), the United States, as it kept on recording deficits in its balance of payments accounts, found itself seriously confronted with two basic provisions of the IMF: (1) all United States dollars, the "standard" currency of the international monetary system, were convertible into gold at the rate of thirty-five dollars per ounce; and (2) the United States is obliged to repurchase dollars at fixed exchange rates from other members of the IMF who wish to sell them to the United States. Because of these two provisions of the IMF, a deficit in the United States balance of payments accounts gave a country with a surplus balance of payments position a set of options:

The function of the IMF is to make the currency of each nation freely convertible into other currencies at an international exchange rate. . . . In practice, stability of exchange is accomplished by the central bank of the foreign nation with a balance of payments deficit buying its currency in world markets with dollars, thereby reducing the supply of its currency and returning the exchange rate to a parity. On the other hand, a country with a surplus balance of payments position will exchange its own currency for dollars to increase the supply of its currency and reduce the price to parity. The surplus country can in this manner increase the dollar holding in its reserve account, or it may elect to redeem the dollars for gold. The policies of central banks are reflected in the composition of their reserve assets and are the result of many diverse factors, one of which is the current strength of the dollar.8

With the convertibility of dollars into gold provision, the basic stability of the dollar was questioned by foreign countries having a balance of payments surplus any time the United States gold reserves fell to a level that caused foreigners to question the ability of the United States to redeem outstanding dollars with gold at the fixed price. Unless the United States maintained a somewhat stable balance of payments position, it was inevitable that foreign ownership of dollars would increase, resulting in a corresponding increase in United States liabilities. "Even if the relative redemption percentage of dollars into gold remain[ed] constant, the increase in dollars available in foreign hands alone [would] result in a more rapid depletion of United States gold reserves . . . ."9

8. Young, supra note 5, at 423 (footnotes omitted).
9. Id.
Such causal relationships, reflecting the chain-like progression of events in a nation facing a balance of payments deficit, ultimately resulted in a lessened confidence in the stability of the dollar.

The second IMF provision, dealing with the repurchase of dollars at fixed exchange rates, coupled with deficits in the United States balance of payments accounts, produced an effect upon the stability of the dollar which was largely emotional and thus uncontrollable—the fear that United States reserves might be insufficient to permit repurchase of all dollars that would be offered in case of a speculative run on the dollar.

The very chance that the United States will be unable to meet its repurchase obligations, abetted by the possibility of continuing inflationary pressure on the dollar, increases the instability of the dollar. The greater the United States international obligations in relation to its reserves, the greater will be the instability of its currency. Because most other Western currencies are based at least in part on dollar reserves, the stability of these currencies is threatened as well. While under the present international monetary system moderate United States balance-of-payments deficits may be needed to provide a necessary increase in world liquidity, large deficits are too great a destabilizing influence. Consequently, the United States has been forced to take action designed to reduce its large balance-of-payments deficit in order to maintain international confidence in the dollar.\textsuperscript{10}

II. MAJOR CAUSES OF THE UNITED STATES BALANCE OF PAYMENTS DEFICITS

History shows two major causes of the United States balance of payments deficits. Indeed, throughout the fifties, the deficits were neither alarming nor harmful and were readily explainable.

Although the United States' international balance of payments had been slowly losing ground through the 1950's, the annual increase in the country's deficit was not then insupportable in view of the fact that much of the deficit was attributable to the dollar increasingly becoming the reserve currency of the international economy: if the dollar was to be a reserve currency, other countries had to own dollars. . . . By 1960, the deficit had reached proportions sufficient to call into question international confidence in the dollar.\textsuperscript{11}

\textsuperscript{10} Comment, American Private Direct Investment In Eastern Europe: Intersection of Business Interests and Foreign Policy, 21 Stan. L. Rev. 877, 918 (1969) (footnote omitted).
\textsuperscript{11} Lancaster, The Foreign Direct Investment Regulations: A Look at Ad Hoc
As the deficits became more alarming, throughout the 1960's, several serious errors in financial judgment by the United States Government stood out as the major causes of the balance of payments crisis. The first error in judgment was that the United States, in providing aid for the rebuilding of war-torn economies after World War II, did so primarily on a grant basis rather than in repayable loans. The rationale was that the economists administering the foreign aid program "had so little confidence in the success of their plans for European recovery that they fully expected European trade and finance to continue indefinitely in a deficit relationship to the United States." What happened, though, was that Europe did recover, and the European countries began to have surplus balance of payments accounts. One writer pointed out what would have been the effect if the United States had provided repayable loans to, for example, France:

If instead of largely forgotten grants—and the total grants by the United States to France aggregate $7 ½ billion—we now had some Marshall Plan loans repayable by France with her excellent gold and reserves, all of the current gold problems of the United States, resulting from French demands for gold, would vanish.

But even the return of the loan basis to the foreign aid program has mixed blessings.

In the more recent past, especially since 1958, the foreign aid program has been returning to a "loan" basis of a sort, but these loans are largely in terms of repayment in local currencies instead of dollars and lack any maintenance-of-value clauses. Thus, the United States loses to the extent of any devaluation or depreciation of local currencies. For example, the U.S. Treasury has been selling Indonesian rupiahs at an exchange rate of 5,000 to $1 in comparison to U.S. acquisition cost of those currencies under loan agreements at an exchange rate of 45 to $1, a loss on the Indonesian currency loans of more than $.99 on the dollar.

The second error in financial judgment concerned expenditures for United States military operations abroad. During World War II, the United States carried out its military operations abroad

13. Id. at 407.
14. Id. at 411.
15. Id. at 412.
without experiencing any balance of payments problems. "The reason was that under lend-lease and reverse lend-lease, there were few if any transfers of credits or cash between the United States and foreign countries." Thus, the need of each government for the currency of the other was reduced to a minimum. However, after World War II, the principle was established by the United States that the country would go over to a "pay as you go" basis for the local support of our military operations. "[A]nd since the United States did the 'going' by maintaining troops and dispatching equipment abroad, it also did the 'paying'." Thus, the presence of United States military forces within a foreign country became an automatic guaranty of financial prosperity for that country, which could then have a surplus balance of payments.

While the above two major causes of the United States balance of payments deficits could be considered long-term causes, the 1960's saw other significant causes of a shorter-term variety—causes which ultimately led to a balance of payments crisis and the creation of the FDIR.

The renewed increase in private loans and investments abroad, the growing cost of the Vietnam war, the inflationary spiral, the diminishing trade surplus, the jump in American tourism abroad, and the loss of confidence in the dollar following the devaluation of the British pound threatened a monetary crisis of serious magnitude. The mandatory Foreign Direct Investment Regulations are part of the response to that crisis.

III. FOREIGN DIRECT INVESTMENT AND THE BALANCE OF PAYMENTS

The concept of foreign direct investment and its effect upon the balance of payments can be looked upon in three different manners—each of which focuses upon a different relationship. Yet, a look at the total picture is illuminating and necessary in order to analyze the effectiveness of the FDIR as a means of improving the

16. Id. at 413. Lend-lease worked in this way:

Under lend-lease the United States furnished its military allies with all the military hardware, guns, airplanes, tanks, ammunition, clothing, food stuffs, and the use of ships. . . . In return, the United States received as reverse lend-lease, in the U.K. and later in France and other European countries, use of local real estate for flying fields, barracks, storage depots, maneuvering, local commodities, and services.

Id. (footnote omitted).

17. Id. at 417.

18. Comment, supra note 7, at 497.
United States balance of payments position.

In statistical terms, foreign direct investment is a debit item in determining the balance of payments. It is an outflow of capital which gives foreigners the same purchasing power they would have if the money came from the sale of imports to the United States. Viewed in a more realistic manner, however, direct foreign investment involves the creation of a foreign enterprise to sell goods and services and to generate profits for reinvestment abroad or for repatriation to the direct investor in the United States. In a larger sense, foreign direct investment has been a major factor in the economic growth of the world and has made available to other nations not only dollars, but also advanced technological and managerial skills.¹⁹

Direct investment generally refers to money spent on corporate capital stock, bond purchases, plant purchases abroad, and similar investments. Yet, the Regulations require an understanding of the refinements of international balance of payments accounting on the above conception of investment abroad.²⁰

IV. FDIR—A MEANS OF SOLVING THE BALANCE OF PAYMENTS CRISIS?

If foreign direct investment is considered solely as an outflow

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¹⁹. Young, supra note 5, at 427 (footnote omitted).
²⁰. See Lancaster, supra note 11, at 99-100 (footnotes omitted), where the author states:

The Regulations apply only to certain of those expenditures which might commonly be regarded as foreign investment or as affecting the balance of payments. Buy a Rolls-Royce in the United Kingdom and drive it around the streets of Dallas, buy a chateau in the Loire valley in France and vacation in it, buy a ship in Japan and use it in the coastwise trade in the United States, buy a railroad locomotive from Germany and use it in Pennsylvania, buy a Belgian patent for your Cleveland factory's use—all of these transactions may have adversely affected the United States' balance of payments position, but none will be regarded as a direct investment or a transfer of capital . . . within the reach of the Regulations . . . . On the other hand, sell one hundred thousand washing machines to your British subsidiary for resale to customers there on what they call "hire purchase" and be paid off by your subsidiary as the retail customers pay for their machines; buy an offshore oil-drilling rig from a yard in New Orleans and tow it to a spot in the southern Caribbean for more than a year's work manned by Americans and supplied by Americans; have a ship built in an American shipyard and assign it to a foreign-flag subsidiary; take some old well-drilling equipment where it is rusting in storage in the Orient and eating up rental payments to a foreign warehouse, and contribute it as your share of a joint venture in the Middle East; cart a few shiploads of American road-building equipment to France and build a road there in thirteen months entirely with American personnel—in each case a transfer of capital resulting in a direct investment will result and will be subject to the OFDI restrictions (unless there is a corresponding transfer of capital back to the investor before the end of the same year and, for OFDI purposes, from a country in the same scheduled area).
of capital—a debit item—in determining the United States balance of payments position, the investment controls, by reducing the outflow of capital, should have a favorable impact upon this country's payments position. But since the major causes of the deficits lie elsewhere, as previously discussed, the creation of the FDIR constituted more of a political than an economic response to the payments crisis.

When the balance-of-payments problem became more pressing for the United States in 1963-1964, the attack was focused on private lending and private investment abroad, rather than on foreign aid and foreign military expenditures and assistance. The private sectors presumably constituted easier targets that were available in ways that did not involve the vested interests and techniques of government. Hence, it was concluded to tax and control private lending and investment rather than to reform foreign aid and the military. Moreover, these taxes and controls fitted in with the need felt for allocation of sacrifice in the current crises.21

Yet even with the favorable impact of investment controls, a favorable over-all economic position will not necessarily result. Other factors, besides foreign direct investment, have a considerable impact upon the economic picture of the United States and of each of the foreign states in the world. Foreign trade, foreign exchange, economic development, balance of payments as well as foreign direct investment are all a part of such an economic picture but these factors do not necessarily act in concert, so that improvement in any one or two of these will not necessarily result in a favorable economic position.

Therefore, the world's economy is, like the law, a seamless web. Granted, variations of some magnitude as between countries will always be present, and, on a short-term basis, improvement in any of the respective components will register as a favorable indicator in the over-all situation. Unfortunately, governments tend to suffer a degree of myopia when they assiduously apply their efforts to one or two of the components in the mistaken belief that these are actually the total problem instead of symptoms. Like symptoms of disease, they too must be treated if total recovery of the patient is to be achieved.22

Of course, the above discussion of the impact of the FDIR on the balance of payments problem has been premised upon the belief that a reduction in outflow of capital would improve the balance of payments. Indeed, such was the view of the United States Government. But this belief has been subject to harsh criticism. As one writer argues:

Is there a demonstrable case for this view that a major cause for the U.S. balance-of-payments crisis is private lending and investment abroad? Obviously, any bank which lends money abroad or any business enterprise which makes capital investments abroad is by definition making a negative contribution to the balance of payments of the United States—that is, the outflow of loan and investment funds from the United States to foreign investment funds from the United States to foreign investment adds that much to the deficit in the balance of payments. But that definitional answer fails to take into account the inflow of dividends, interest, royalties, and fees received on private investments abroad. And that answer overlooks the close relationship of investment abroad to export trade. It is only a small chapter in the story if we look at the capital outflow alone. When we add up the investment income received by the United States from investment abroad, deduct the investment income paid out to foreigners on their investments in the United States, and deduct the current capital outflow, we do not find figures to support a conclusion for reducing United States investment abroad for balance-of-payments reasons. . . . Continued reliance on restrictions of capital outflow for private investment abroad, which have invariably been productive of greater future earnings, is a short-term situation and indeed slays the goose that lays the golden egg.

In writing this evaluation of the FDIR—their goals, policies and effectiveness—a major obstacle to an accurate evaluation of the current effectiveness of investment controls "lies in the ingrained habit of both the press and certain government officials to use different guidelines when reporting the current state of affairs in this area." Yet regardless of this difficulty, after four years of the mandatory FDIR in the United States, our balance of pay-

24. Hynning, supra note 12, at 405.
25. Weeks, supra note 1, at 244.
ments problem is still with us, and there is no conclusive evidence that the FDIR are any more or less responsible for the current deficit. Thus, while the goal remains clear, the path to it has not yet been found.

This in essence is the crux of the entire subject of international trade and finance—no one can agree on the best specific methods of assuring continued improvement. In fact, about the only absolute source of agreement is that the proper balance between inflows and outflows of capital is essential for a properly functioning international as well as domestic economy. The goal but not the means seems, then, to be the only item which is clearly defined.26

And so the subsequent discussion in this article shall necessarily limit itself to an underlying issue—the extent to which the FDIR succeed in meeting four priorities with which foreign investment abroad should be concerned:

First, strengthening of the domestic economy of the investor's own country through the returns on the invested capital. Second, working to increase the individual investor's wealth. Third, promoting the economic development of the country and countries in which the investment is made. Fourth, developing a healthy and stable international economic situation, kept so through sound monetary policies and an extremely high degree of international cooperation.27

V. SUMMARY OF THE SPECIFICS OF THE FDIR

The FDIR impose certain restraints on investment in "affiliated foreign nationals" by United States "direct investors".28 An affiliated foreign national (AFN) is a foreign corporation, partnership, or unincorporated business venture in which at least a ten percent interest is owned by a "person", i.e., an individual, corporation, business venture, trust or estate, within the United States.29

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26. Id. at 251.
27. Id. at 250.
That "person" is called a direct investor (DI).\textsuperscript{30} To determine whether a "person" has acquired sufficient interest to be a DI, the interest is measured by voting power if the AFN is a corporation, and by a right to share in profits if the AFN is unincorporated.\textsuperscript{31} Notwithstanding the above, the Secretary of Commerce retains full power to determine that any business is an AFN of any "person" within the United States and to determine the scheduled area in which such affiliated foreign national is located.\textsuperscript{32}

Direct investment, which is calculated during a given period, usually on a calendar year basis, consists of (1) the "net transfer of capital" by the DI to its incorporated and unincorporated AFNs plus (2) the DI's share of earnings of its incorporated AFNs which have been reinvested.\textsuperscript{33} Thus, the concept of direct investment as well as that of "net transfer of capital" refers to the net total of transactions over a period of time, not to a single transaction. "Net transfer of capital"\textsuperscript{34} may be briefly summarized in the following manner:

Generally, a transfer of capital by a DI to an AFN is a transfer of funds or other property that increase the DI's aggregate equity or debt investment in the AFN. Conversely, a transfer of capital by an AFN to a DI is generally a transfer of funds or other property that reduces the DI's aggregate equity or debt investment in the AFN.

Net transfer of capital to incorporated AFNs for a given period is the aggregate of transfers of capital by the DI less the aggregate of transfers of capital by the incorporated AFNs to the DI during the same period. Net transfer of capital to unincorporated AFNs for a given period is the DI's share of the aggregate increase or decrease in the aggregate net assets of such AFNs.

\textsuperscript{30} § 305.
\textsuperscript{31} § 304(b)(2).
\textsuperscript{32} § 304(b)(4).
\textsuperscript{33} § 306.
\textsuperscript{34} § 313. The concept "net transfer of Capital" is discussed generally in Lancaster, supra note 11, where the author states at 105:

A net transfer of capital is defined in terms of all of a direct investor's AFNs in a particular scheduled area. From a balance of payments point of view, it matters not at all whether a direct investor has one AFN or hundreds in a particular country or area. What is of importance is the sum total of transactions to a particular country or area. For the foregoing reason, the separate identities of all of a direct investor's foreign business operations within the same scheduled area are ignored, for their numbers do not affect the sum of the transactions between the direct investor and his AFNs in the area.
(whether such net increase or decrease results from transfers of capital, earnings or losses).35

Besides regulating positive direct investment, the FDIR restrict the amount of "liquid foreign balances"—money on deposit in foreign banks and negotiable or non-negotiable instruments of unaffiliated foreign nationals with a period of less than a year remaining to maturity when acquired—that may be held by a DI. Ordinarily, the amount of such balances that a DI may hold at the end of each month cannot exceed the greater of $100,000 or the average month-end amount of liquid foreign balances held by the DI in 1965 and 1966.36

The FDIR assign each of the countries of the world to one of three scheduled areas, A, B, and C.37 Direct investment by a DI is generally determined on the basis of a scheduled area, reflecting aggregate transactions involving all AFNs in such schedule. Schedule A consists of the developing countries while Schedule B includes a limited number of industrialized or partially industrialized countries, such as Australia, Ireland, Japan, New Zealand, the United Kingdom, certain Middle East oil-producing nations and Spain. The countries in Schedule C include those not included in Schedule A or B, such as South Africa and the industrialized countries of Western Europe. The FDIR do not restrict direct investment or liquid foreign balances in Canada, although any DIs investing in Canada are required to file with the OFDI the same reports that DIs with AFNs in other countries must submit.

The amount of positive direct investment that a DI is permitted to make during a calendar year depends upon which "allowable" the DI chooses. A DI may elect one of two "minimum" allowables: (1) worldwide positive direct investment of not more than

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35. Office of Foreign Direct Investments, Summary of the Foreign Direct Investment Regulations (May 3, 1971). See § 312, on "transfers of capital", and § 313, on "net transfer of capital". The very act of becoming a DI for the first time is regarded as a "transfer of capital". § 312(a). It should be noted that if one DI disposes of all or part of its interest in an AFN to another entity which then becomes a DI in its own right with respect to such AFN, there is no transfer of capital because nothing has left the United States and, thus, there has merely been a redivision of the interests that existed before the sale. § 312(c)(1). For the implications of this provision to prospective purchasers of a DI's interest in an AFN, see generally Lancaster, supra note 11, at 111-12. On determining the amount to be used in calculating "transfers of capital", see generally Lancaster, supra note 11 at 119.

36. § 203.

37. § 319.
$2,000,000 each year,\textsuperscript{38} or (2) $2,000,000 per year in Schedules B and C plus an additional $4,000,000 a year that may be invested only in Schedule A.\textsuperscript{39} If a DI chooses to use one of these allowables, it cannot shift to the other in the following year without OFDI authorization. There appears to be underlying these allowables a policy decision which is indeed significant:

These provisions, then, appear to evince a clear policy to alleviate the previous bias in the OFDI program against smaller investors having no base period investment history while at the same time guarding against larger investors who might otherwise elect the section 503 [$2,000,000 worldwide] allowable to circumvent the purposes of the program. On the other hand, the recent adoption of the section 507 supplemental allowable of $4 million for Schedule A investment in addition to investment in Schedules B and C... may render the Regulations superfluous for all but the biggest investors.\textsuperscript{40}

Alternatively, a DI may choose one of two other allowables. The "historical" allowable authorizes an annual amount of positive direct investment in each schedule area based upon the following percentages of the DI's average annual direct investment in the respective area in the years 1965 and 1966: Schedule A, 110 percent; Schedule B, 65 percent; and Schedule C, 35 percent.\textsuperscript{41} The "earnings" allowable permits a DI an annual amount of positive direct investment in each scheduled area based upon 40 percent of its share of the previous year's earnings of its AFNs in the respective scheduled area.\textsuperscript{42} This latter allowable too has an underlying policy significance:

In order to benefit the investor with little or no historical allowables, the section 504(b) optional earnings allowable was instituted... The rationale for the earnings allowable, which is an important departure from the base period concept, is that earnings should bear a closer relationship to our balance of payments objectives and that quotas based upon earnings provide a self-applying formula for the growth and expansion of direct investment abroad. Also, the earnings allowable can be increased or decreased according to the needs of the current balance of pay-
ments situation. The long-range nature of this planning, however, hints strongly at the possibility that the OFDI program will be with us for some time to come.  

In addition to the four allowables previously discussed, a DI may also qualify for an "incremental earnings" allowable.

This allowable is available on a worldwide basis and is equal to the amount by which 40 percent of the DI's share of the increase in the earnings of its AFNs in the current year over its share of the average annual earnings of its AFNs in 1966 and 1967 exceeds the amount of positive direct investment the DI has available to it under the minimum, historical or earnings allowable.  

The purpose of this provision is to aid DIs having AFNs with rapidly increasing earnings since those investors "may be the largest contributors to the equilibrium of the United States' balance of payments."  

The FDIR provide that all or part of any positive direct investment authorized in Schedule C countries may be made instead in Schedule A or B, and any investment authorized in Schedule B countries may be used instead in Schedule A.  

DIs are also able to meet foreign investment plans through the use of proceeds of "long-term foreign borrowing." Proceeds of long-term foreign borrowing expended in making transfers of capital or "allocated" to positive direct investment are deducted in determining the DI's net transfers of capital or positive direct investment, while a charge against a DI's allowables is made only upon repayment of the borrowing. Subpart J of the FDIR authorizes positive direct investment in excess of a DI's allowables resulting from repayment of long-term foreign borrowing, provided the DI has satisfied certain specified conditions.

The FDIR provide that a DI may apply for a "specific authorization" of positive direct investment otherwise prohibited by the Regulations, a "specific exemption" from complying with certain requirements or provisions of the Regulations, and an "interpreta-

43. Comment, supra note 7, at 520.
44. SUMMARY, supra note 35, at 3.
45. Lancaster, supra note II, at 132.
46. §§ 504, 507.
47. § 324.
48. §§ 306(e), 313(d).
49. § 312(a)(7).
tive opinion" of the Regulations with respect to a particular factual situation.\textsuperscript{50}

Certain reports are required to be filed with the OFDI by DIs.\textsuperscript{51} Both criminal and administrative sanctions are provided for in the Regulations.\textsuperscript{52}

VI. THE TRI-SCHEDULAR APPROACH—FOREIGN AID CONSIDERATIONS UNDER THE GUISE OF ECONOMIC POLICY

The separation of the countries of the world into three distinct Schedules in the FDIR cannot entirely be explained on balance of payments grounds alone. Indeed, such grounds do not require the classification of countries at all. "Certainly the immediate balance of payments effect of a dollar investment in a Schedule A country is no less than that of a similar investment in a Schedule C country. Each investment represents the outflow of one dollar."\textsuperscript{53} But the tri-schedular approach operates to favor investment in certain countries at the expense of investment in others. Clearly political judgments and foreign policy determinations have played a significant role in the formulation of the Schedules, and thus the tri-schedular approach that resulted achieves a distribution of private investment closely akin to the distribution of United States foreign aid. One professor of law elaborates upon the rationale for the use of three Schedules in the FDIR:

It is the judgment of the United States, then, that it is not alone in the struggle for international monetary stability—that the stability of the international monetary system, and with it the stability of the United States monetary system, depends on the economic health of many other countries. Reduction of the level of the United States' imbalance of international payments must not be accomplished at the expense of other nations which are weaker from an international monetary standpoint, if the result

\textsuperscript{50} § 801. Instructions for submitting such applications are set out in detail in Revised Instructions for Submitting Applications for Specific Authorizations, Specific Exemptions or Interpretations (February 23, 1971), in 1971 FOREIGN DIRECT INVESTMENT PROGRAM, published by the Office of Foreign Direct Investment. Reprints are available from OFDI.

\textsuperscript{51} § 602.

\textsuperscript{52} § 701. \textit{See generally} Comment, supra note 7, at 528-29. On the use of settlement procedures by OFDI in cases of noncompliance, \textit{see generally} Freedman, \textit{Administrative Procedure and the Control of Foreign Direct Investment}, 119 PA. L. REV. 1, 82 (1970), and Comment, supra note 7, at 529.

of such accomplishment is to jeopardize the stability of the international monetary system itself.44

Criticism of the FDIR approach has been substantial and three alternative approaches have been suggested. The first suggestion would do away with the Schedules altogether, primarily because of their interference with the flexibility necessary for business investment. As one attorney argues:

International business is in no way carried on under a fragmented three schedule approach. As a result, the Regulations, which provide for progressive restriction as one proceeds from Schedule A through C, have been particularly harsh on the larger international corporations which have made such substantial contributions to the balance of payments. Accordingly, OFDI should conform the Regulations to normal business practice and ameliorate the effects of this three-tiered approach, even if the Regulations are to be continued for the short run. Inducements to investment in the under-developed countries should be confined to the Treasury's income tax treaty program, which program should now be accelerated.55

Of course, "[a]ny controls which curtail the United States' participation in investment in less developed countries run contrary to our most basic long-range foreign policy interests."56 The second suggestion involves the substitution of a new schedular approach, based solely on balance of payments considerations, for the present one.

The [present] system fails to recognize that there are many less-developed countries which have intimate financial relationships with highly developed countries, such as France, which are embarked upon a major onslaught on the dollar. The result of that relationship is that the exemption of countries as less-developed provides a major source of seepage of U.S. funds into France. It would make far more sense to classify the countries into two categories, namely, (A) the countries which enter into satisfactory financial arrangements with the Secretary of the Treasury of the United States for the cooperative defense of the dollar, and (B) countries which do not.57

54. Lancaster, supra note 11, at 97.
57. Hynning, supra note 12, at 432. See also Note, supra note 53, at 171, where the writer states: "If balance of payments effect were solely responsible for the tri-schedular
But the third suggestion calls for the reclassification of countries in the world within the present tri-schedular approach whenever necessary for foreign policy or balance of payments reasons. For example, one writer proposes changing the FDIR's treatment of investment in Eastern Europe:

Accordingly, the President should direct the Secretary of Commerce to use his discretionary power to reappraise the schedule classification of all Eastern European countries. The Secretary of Commerce should then reassign these countries to schedules appropriate to their economic capacities, their need for development capital, and their ability to satisfy these needs from non-United States sources. For example, East Germany's high degree of industrialization and its ability to obtain capital for continued industrialization from the USSR seem to justify its retention in schedule C. On the other hand, the relatively undeveloped economic conditions of Rumania and Bulgaria—very much on an economic par with Yugoslavia—should require that they be placed along with Yugoslavia in schedule A. The other Eastern European nations—Czechoslovakia, Hungary, and Poland—are neither as highly developed as East Germany nor as undeveloped as Bulgaria or Rumania. Because these other countries are at most as developed as other schedule B countries, they should also be placed in schedule B, and perhaps even in schedule C.  

Thus, the present tri-schedular approach is essentially a compromise or blending of foreign policy and balance of payments considerations. The justification for placing each country in a particular Schedule will always be explainable because of this compromise. But since the elements of this compromise often work at cross-purposes to each other, this writer cannot help but wonder if the present tri-schedular approach isn't doing more harm than good as a key provision in the FDIR.

VII. OFDI—A WORKABLE MECHANISM TO CONTROL INVESTMENT ABROAD?

A. At the Domestic Level—Effect of OFDI on Investors

By definition, investment controls interfere with the process of investing abroad by direct foreign investors and the managing of

system, the countries should be allocated to schedules according to their willingness to adopt measures supporting dollar stability.”

58. Comment, supra note 10, at 925-26 (footnote omitted).
such investments. Thus, a basic criticism of investment controls is that they

can result in economic starvation or malnutrition of existing
direct foreign investments by not permitting sufficient flexibility
to the direct foreign investor or by virtually coercing him to seek
investment in, from his standpoint, a less favorable country.\footnote{59}

Indeed, this criticism may be partly responsible for one writer's
characterization of the history of the Regulations "as the story of
rigorous rules being subsequently relaxed\footnote{60}—for example, the in-
creases in the minimum allowables. On the other hand, this criti-
cism illustrates a crucial lack of understanding of the operating
effect of the FDIR—that is, not to restrict investment, but rather
to shift its financing to foreign sources. Also, the OFDI retains a
great deal of flexibility in granting specific authorizations in a
given year.

[S]o long as there is some flexibility in adjusting the aggregate
amount permissible for specific authorizations in a given year, a
decision to grant any particular application for a specific author-
ization will rarely, if ever, have the effect of foreclosing the possi-
bility that a subsequent application of comparable merit will be
granted. Moreover, a decision to deny an application for a spe-
cific authorization has effect for a limited period only, prohibit-
ing the direct investor from undertaking the proposed enterprise
for the remainder of the calendar year but leaving him free to
do it the following year. It may sometimes be true that the im-
 pact of denial will be more severe, at least when the inability to
accept a business opportunity now means that the opportunity
will be lost forever, but in some cases it will be equally true that
the direct investor can take up the opportunity by paying higher
interest rates abroad.\footnote{61}

One writer has suggested that because of the need and desire of DIs
to seek specific authorizations, there has been little opposition to
the investment controls from the business community. "The risk
of courting the displeasure of the federal government apparently
outweighed the value to be gained from attacking the regulatory
scheme."\footnote{62}

One other criticism also made by DIs is that the FDIR are too

\footnote{59. Weeks, \textit{supra} note 1, at 255.}
\footnote{60. Lancaster, \textit{supra} note 11, at 121. Lancaster gives examples at 121-125.}
\footnote{61. Freedman, \textit{supra} note 52, at 73.}
\footnote{62. Note, supra note 53, at 164.
complex and that compliance with them is unduly expensive and inconvenient. Notwithstanding the validity of this criticism, it is met by a favored bureaucratic response, though not necessarily untrue:

Complexity . . . is inevitable where the subject matter is as intricate and difficult to regulate as foreign direct investment. Indeed, simplicity would have resulted in great injustices because of the undoubted ability of multinational enterprises to thwart any simple scheme. Sophisticated business calls for sophisticated regulation.63

B. At the Domestic Level—OFDI as Regulatory Program

The creation of OFDI as a regulatory program, rather than as a legislative one, in response to the balance of payments crisis, appears to have been beneficial to its development and functioning. As one former official of OFDI has commented:

[I]n all probability the most influential factor contributing to OFDI's accomplishments has been the freedom of responsive and responsible men from the straightjacket of the legislative process—a freedom to meet each day's crisis unhampered by the supposed permanence of yesterday's decisions. OFDI has been free to learn from mistakes and make swift changes without unduly prejudicing people who had relied on such mistakes. OFDI has been free to listen to its public on a day to day basis, and to follow closely statistical and financial developments in its area of responsibility. OFDI could not have operated in this manner if its regulatory program had been a legislative program.64

But another writer sees the above view as a common "rationalization for unfettered and unchecked administrative power" and adds: "There is no obvious reason for ignoring the legislative process here."65 And so it would seem that as the Regulations take on a more permanent makeup and as the balance of payments deficits continue, congressional involvement and supervision become more pressing. Since the FDIR "have a potentially pervasive effect on the nation's entire economy and on the rights and privileges of its citizenry, under traditional democratic philosophy, the legislative

63. Comment, supra note 7, at 562.
64. Lancaster, supra note 11, at 134-35.
65. Comment, supra note 7, at 539.
branch of government should exercise ultimate control over their dimension and contour.\textsuperscript{66}

Finally, two other benefits have occurred at the domestic level as a result of the creation of OFDI—perhaps benefits of a lasting nature:

First, the Regulations have created a vastly increased awareness of the balance of payments problem, particularly in the business community. Corporate executives have been forced to consider the impact of their transactions in balance of payments terms. In the process of adapting to the Regulations they have learned the techniques for minimizing the adverse impact of their foreign transactions. Hopefully, this awareness will continue to work for the United States long after the Regulations have become relics. The second benefit is the knowledge which has been gained by the administrators of the Program. At the beginning of the effort, the accounting techniques employed to adjust international monetary reserves had never been matched with the commercial transactions they were supposed to represent. The Program has given added insight into this correlation and, as a result, has given additional meaning to the balance of payments statistics. This knowledge can be the cornerstone of a better and more permanent solution to the balance of payments problem.\textsuperscript{67}

C. At the International Level—The Effect of Repatriation upon the DI

The limits placed upon authorized direct investment by the FDIR force the DI to elect between repatriating that portion of earnings that exceeds the authorized allowable or shifting those earnings into holdings that do not qualify as liquid foreign balances. Since the latter is quite difficult to accomplish, the DI is under pressure to seek the payment of dividends from its incorporated AFNs—that is, repatriation—rather than the reinvestment or retention of earnings. Thus, the DI is placed in a position where he must face the implicit repatriation requirement of the FDIR and, on the other hand, contend with foreign governments and shareholders in the operation of the foreign business. Foreign governments, acting through exchange controls or other restrictions, or shareholders, acting simply by outvoting, may effectively prevent a DI from complying with the repatriation requirement. Of


\textsuperscript{67} Note, supra note 53, at 176.
course, a DI may be able to increase the amount repatriated from AFNs in other countries not subject to such interference or structure any further investment plans around the use of long term foreign borrowing. Yet each of these alternatives represents but a possible course of action for the DI—he may find himself without any effective way of fulfilling his investment objectives and needs.

The pressures put upon the DI who is not easily able to comply, if at all, with the repatriation requirement find their counterpart, ironically, in those put upon the DI who is able to comply, in that such DI may find himself in violation of certain foreign corporation laws. One writer, focusing upon Europe, with its heavy concentration of United States foreign direct investment and its strict limitations imposed by the FDIR in regard to increased investment by DIs, poses the basic problem:

A decision by a DI not to reinvest the earnings of its AFNs raises the important issue of "whether and to what extent the DI, in complying with the Regulations, can cause the board or the shareholder's meeting of the European subsidiary to determine its reinvestment policy according to the DI's repatriation obligation rather than according to their best business judgment as required under European corporation law." One can argue that causing the payment of dividends by the AFN, where the reinvestment or retention of earnings would have been the clearly appropriate internal business decision, violates the fiduciary obligation of the DI as a member of management or as a controlling shareholder to act in the corporate interest and to protect the interests of minority shareholders. 68

The seeds are thus sown for conflicts at an international level as a result of the FDIR.

D. At the International Level—The Effect of OFDI upon the Host Countries

There is no question that the OFDI operates so as to interfere in the economic affairs of the host countries in which the direct investment is made. But there is some question as to whether the interference is beneficial to the host countries or further proof of American "economic imperialism."

Forced repatriation of earnings from AFNs, whether direct or indirect, tends to deny the primacy and legitimacy of the host

68. Comment, supra note 7, at 547 (footnotes omitted).
country's jurisdiction and control over its own economy, gives credence to the claim that United States direct investment is conducted primarily according to the needs of United States economic policy, and raises suspicion within the host country that its resources are being exploited. . . . The reaction of host countries is entirely predictable: retaliation and reciprocal jurisdictional claims will be made, and foreign states will treat American subsidiaries operating within their territory, as aliens, denying to them many of the benefits that are available to domestic companies. More specifically, OFDI, in forcing American companies to borrow extensively in Europe, may cause local firms considerable anguish if credit is tight: American firms are good risks. Also there is no doubt that the Regulations will worsen the balance of payments position of host countries to the extent that capital investment inflow is restricted and earnings are forcibly repatriated. To many observers, the Regulations represent but another American interference in the affairs of other countries and further proof of American "economic imperialism."  69

Of course, American "economic imperialism" has its justification. The argument is that this country has a legitimate interest in regulating the overseas investment of its nationals, even where that regulation indirectly affects the operations of foreign business entities, and the balance of payments accounts of other nations. 70 Thus, since "many AFNs, especially wholly owned subsidiaries, are despite the "veil" of foreign incorporation, still part of an overall United States enterprise, affecting and operating in the interests of that enterprise," 71 regulation of them by OFDI serves an economic purpose of a protective nature rather than one of an expansionary nature.

The above justification, though resting on logical grounds, has run into considerable difficulties in practice, compounded by an ever-increasing emotional hostility in many countries of the world towards United States foreign direct investment. Witness, for example, the growing number of expropriations of United States investments in various foreign states. But it cannot be denied that American investment does bring distinct and considerable advantages to host countries. The inflow of capital, technical know-how, advanced technology, capital goods, and managerial expertise to the host countries together with the increase in exports from the

69. Id. at 549-50 (footnote omitted).
70. Id. at 550.
71. Id.
host countries and generated by American investment constitute benefits of a very significant and lasting nature. Host nations wishing to strengthen their industrial and technological capacity with maximum speed and minimum expense do need the benefits of American investment abroad.\footnote{See Comment, supra note 10, at 885 n.35.} Thus, conflicts between host countries and OFDI may be unavoidable as long as the need for American investment abroad continues.

One possible effect of OFDI on the international community of both economic and political significance is that the program falls heaviest on the multinational enterprise and, in effect, represents a step, even though unilateral, toward their control. The Regulations may encourage further action in this area by foreign governments and may ultimately result in international agreements. The United States, then may indirectly be forcing the world's hand on an issue in need of considerable attention. \footnote{Comment, supra note 7, at 563-64.} Because of this effect, it is likely that the FDIR or some form of them will become a permanent fixture of United States economic policy.

VIII. CAN THE FDIR BE REMOVED?—SHOULD THEY BE REMOVED?

Upon balance of payments considerations, the purpose of the FDIR were and are simply to reduce the outflow of American funds expended in direct investment. Since the Regulations operate to shift financing of United States direct investment to foreign capital markets, not only by direct investors in their own right but also through increased foreign affiliate borrowing, and since long term foreign borrowings have steadily increased since 1968,\footnote{OFFICE OF FOREIGN DIRECT INVESTMENT, RESULTS OF FOREIGN DIRECT INVESTMENT PROGRAM IN 1970, (July 29, 1971) (reprints available upon request).} it appears the Regulations are fulfilling the above purpose. Indeed, the implementation of such controls has belied the fear that they would hurt the United States' competitive position in the world market place because investment opportunities would be lost to other countries and would be difficult to ever regain.

Yet the use of long term borrowing by DIs presents a future problem with considerable significance for the United States balance of payments. As one professor of law explains:

\footnote{See Comment, supra note 10, at 885 n.35.}
[T]he very success of the Administration in diverting American business to foreign capital markets may serve to "lock in" the Program . . . . If restrictions on outflows of American capital are removed, then the only factor preventing American business from retiring its Eurodollar offerings will be the difference in interest rates prevailing between the Eurodollar bond market and the United States capital markets. The outstanding foreign indebtedness of American corporations . . . is referred to as the "overhang" in OFDI circles. This huge potential outflow is presently held up only by the Regulations, which treat repayment of foreign borrowing as a transfer of capital to the extent that the proceeds were spent in foreign direct investment.\footnote{Lancaster, supra note 11, at 93-94 (footnotes omitted).}

Thus, it appears that any future outflow to pay off the considerable debt overhang will itself have to be regulated, though not necessarily through the use of a full OFDI program. However, one writer believes little, if any, regulation would be necessary if the controls were ended, and cautions against retaining the controls merely because of the huge debt overhang:

\[\text{[T]he argument that a sudden end to the controls might cause massive refinancing of outstanding foreign borrowing is a shallow reason for retaining the controls. The interest rate diferential which motivates the desire to refinance foreign loans could easily be eliminated by a tax applicable to refinancing. Alternatively, refinancing of outstanding long-term foreign borrowing could be prohibited altogether as a condition on the revocation of the controls. Moreover, the argument is self-defeating. The longer the controls remain in effect the more serious the refinancing problem will become as more and more borrowing accumulates.}^{76}\]

The necessity to obtain foreign financing may entail certain disadvantages for DIs:

\[\text{[T]he necessity to obtain foreign financing may force many to borrow who have funds of their own available. Foreign financing sought in foreign capital markets may not be available to small and medium-sized investors or may be more costly than funds obtained from United States sources. Also, although foreign financing has been readily available until now, should foreign capital markets tighten or the interest expense diferential widen, then the purpose of the program—to shift the financing of for-\footnote{Note, supra note 53, at 168-69 (footnotes omitted).}]}\]
eign investment without interfering in the investment pro-
cess—will have been undermined. 77

The OFDI, however, has addressed itself to the problem of non-
availability of foreign financing by allowing applications for speci-
fic authorizations of positive direct investment in excess of the
applicable amounts generally authorized under the Regulations. 78

In conclusion, this writer does again refer to the previously
discussed four priorities with which foreign investment should be
concerned 79 and the effect of the OFDI upon them. Surprisingly,
the FDIR have not functioned as investment "curbs" since regu-
lated foreign direct investment has steadily increased since the
"curbs" were instituted 80—no doubt because of the reliance on long
term foreign borrowing and the increasing of the allowables. Thus,
it would appear that the domestic economy of the United States
has been strengthened through the returns on the invested capi-
tal—that is, the inflow of capital to the United States—and the
individual investor's own wealth has been increased as well. For-
eign investment cannot but promote economic development in the
countries in which the investments are made, and this third priority
appears to be well satisfied. However, the goal still remains of
"developing a healthy and stable international economic situation,
kept so through sound monetary policies and an extremely high
degree of international cooperation." 81 The United States' balance
of payments crisis remains after the creation of the FDIR because
they represent only a response to that crisis—perhaps favorable,
perhaps not—but not an attempt to deal with the major causes of
the crisis.

Viewed in the most favorable light, the regulation of foreign
direct investment will result in an immediate improvement in the
United States balance of payments position. At worst, the Regu-
lations will ultimately lead to a reduction of future capital inflow
to the extent that the payments deficit can be corrected only by
devaluing the dollar. Regardless of the outcome, it is demonstra-
bly clear that the underlying reasons for the balance of payments
deficit are attributable to causes other than foreign direct invest-
ment. Until the economic planners in Washington recognize that

77. Comment, supra note 7, at 557-58.
78. See note 50 supra.
79. See note 27 and accompanying text supra.
80. See note 74 supra.
81. Weeks, supra note 1, at 250.
the real source of the financial difficulties of the United States stem from the domestic and international fiscal policies of the Government, the deficit crisis will continue to grow, and further tightening of controls over private enterprise will be convenient solutions.82

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82. Young, supra note 5, at 446 (footnote omitted).