The Foreign Investment Debate

Opening Markets Abroad or Closing Markets at Home?

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Conditioning Investment Is a Losing Strategy

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International investment flows are the key to growth for both the domestic and the global economies. The problem is that the climate for investment in the United States and for R&D partnerships internationally may be getting worse. The chief officer for technology strategy at a major European multinational recently said that American firms are wary of entering partnerships with his company because the Americans risk being denied a federal contract by being linked with a German firm. In fact, he added, the legal obstacles to investing or participating in R&D joint ventures are greater in the United States than in Japan. Clearly, our nation must take a step back and carefully consider what is happening to U.S. investment policy.

In the United States we used to treat all companies equally. But Congress is now drifting toward a policy of treating companies differently based on their nationalities—conditional national treatment (CNT). The standard is not based on the worth of the company, but on the practices of the company's home country. A company from a "bad" country may get penalized. This is a bad strategy for the American economy. We should be encouraging, not discouraging, foreign investment. The United States has benefited disproportionately from the explosion in international investment. A key advantage has been our ability to attract international investment and to provide a climate where transplant companies are welcome, jobs are created, productivity is enhanced, and the industrial base is transformed.

Attracting the Best and the Brightest

Both Japan and Europe have great companies, but only the United States has the best Japanese, European, and U.S. companies in the same place.

That translates into a tremendous performance advantage for the twenty-first century. International investors account for one-fourth of all U.S. exports (roughly $100 billion) each year. Japanese companies in Japan say they would love to attract Western researchers, but it is very difficult to get them to relocate permanently to Japan. Before a country can harness the world's best brainpower, it is necessary for companies to invest in that country's economy. The great competitive advantage the United States has over Japan is that we can attract that brainpower.

Consider the returns in terms of productivity growth. The ability of the United States to attract international investment has been critical to the sweeping economic transformation and improvements in productivity growth that the United States has achieved over the past decade. U.S. productivity growth has outdistanced that of its major rivals in the advanced industrialized countries. International investment is the key to this growth. Recent studies by the McKenzie Global Institute[1] and the Organization for Economic Cooperation and Development (OECD)[2] show conclusively that international investment stimulates productivity, employment, and economic growth. The U.S. experience demonstrates that offshore manufacturing facilities, or transplants, play a particularly important role. In the United States, foreign-owned manufacturing companies have higher productivity rates and invest more in plant and equipment than U.S.-owned manufacturers, for example. (For details see the productivity section in chapter 8, and figure A–5.)

Transplants and the Technology Base

Transplant manufacturers also play a key role in developing the U.S. technology base. They transfer to the domestic economy state-of-the-art technology and such state-of-the-art business practices as total quality management, team-based work organization, the involvement of supplier in the innovation process, and the involvement of workers in productivity- and performance-improving measures. Fifteen percent of the total U.S. R&D base comes from foreign affiliates. Data that I compiled on the global R&D laboratories in the United States show nearly 400 international R&D units in the United States that together spend more than $11 billion per year on R&D.[3] (See the R&D and technology section in chapter 8, and figure A–7.)

Foreign investment, according to the OECD, is also good for employment, creating new jobs at a faster rate than domestic investment does in ten of the fifteen advanced industrial nations studied. In the United States, foreign investment has generated nearly 5 million jobs for American workers, with employment concentrated in the technology-intensive and high-wage manufacturing sectors. (See the employment and jobs section in chapter 8, and figure A–12.)

The Transforming Power of Japanese Investment

Some critics of an open investment environment have singled out Japan as a unique case that perhaps deserves special attention from the U.S. government. It is important to note, however, that over the past decade, 1,000 Japanese manufacturing plants have been established in the United States. Automotive-related sectors are home to 500 of these plants, which brought $26 billion in investment and created 110,000 direct manufacturing jobs. Contrary to the stereotype of these plants as screwdriver assembly plants, they have played a powerful role in transforming how American managers view production organization and labor-management relations, helping managers to harness workers' minds as well as their hands. (See the transplants section in chapter 8, and table A–4.)

Research also shows that, contrary to popular belief, Japanese companies do not avoid unions. An economic analysis of the location decisions of more than 450 Japanese-owned automotive-related establishments conducted in collaboration with Donald Smith of the RAND Institute has shown conclusively that these companies locate themselves in urban areas with high union concentrations. The key to their location decisions is being close to a hub assembly facility that they supply.[4]

Japanese steel makers have also invested heavily in state-of-the-art galvanizing and finishing facilities close to these hub assembly facilities. While some claim the Japanese investments in the U.S. steel industry are a positive outcome of trade restrictions, the real reason for these investments was to provide high-quality steel to the automotive transplants. In a number of cases, assembly transplants became so disgruntled with the low quality of the finished steel produced by traditional American steel makers that they asked their Japanese steel suppliers to relocate to America.[5]

All in all, Japanese investment in the United States demonstrates the transforming power of foreign investment. The industrial Midwest provides the prime example. This region, cast aside by many as a rust belt or a center of industrial decline, is today the nation's export belt and one of the world's most competitive manufacturing areas for autos and consumer electronics. Thanks to the inflow of international investment, the United States has witnessed an economic miracle of sorts.[6]

Europe, by contrast, provides an example of what the United States can expect from investment protectionism. For the past decade, Europeans have attempted to limit international investment, and in the process they have managed to forestall the industrial restructuring that the United States experienced in the 1980s. They are now paying the price, as their companies scramble to meet the tests of global competition. Protectionism has hurt the competitiveness of the European steel, auto, and computer industries.

Instead of emulating these mistakes and erecting barriers, U.S. policy makers—particularly those in Congress—should stop the drift toward conditional national treatment. CNT is a bad idea. It undermines the GATT, and it creates a break with the past. In the end, it will hurt us badly. The United States must try to maintain an attractive place for global capital, technology, and management. Only then will American managers and workers be able to compete in the 1990s and beyond.