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FOREIGN INVESTMENT: Difficulties in Addressing Public Policy Concerns

Statement of
Allan I. Mendelowitz
Director, International Trade, Energy,
and Finance Issues

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Transportation
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Mr. Chairman and Members of the Committee:

I am pleased to testify today before this Committee on the subject of foreign direct investment in the United States.

As you know, recent increases in foreign investment have raised concerns about the consequences of foreign ownership of U.S. assets and about the adequacy of government statistics on foreign investment. It is understandable that the public wants to know more about foreign investment, since foreign ownership inherently means that key business decisions can be made overseas on such matters as research, investment, employment, and location.

In our work on this subject, we have tried to identify specific concerns about foreign investment and the types of data available or needed to analyze these concerns. In general, we believe improvements in the available foreign investment data would benefit public understanding of an economic trend likely to continue over the next few years. We also believe that if GAO had access to certain types of foreign investment data that are now closely restricted, this access would allow us to better respond to congressional interest in improving public understanding of foreign investment.

We have found that some questions cannot be answered because of the limitations of the government's foreign investment data. The general problems with the data system of the Bureau of Economic Analysis include timeliness, consolidated reporting, classification methodology, and access to data. We have also found some questions whose answers require either policy judgments about the future behavior of foreign investors or different kinds of data than foreign investment data.

PURPOSES AND LIMITATIONS OF GOVERNMENT DATA

Let me first take a moment to summarize the purposes and limitations of the government's databases on foreign direct investment in the United States.[1]

Cumulative foreign direct investment in the United States is measured in two different ways by the Commerce Department's Bureau of Economic Analysis (BEA), which has primary responsibility for collecting such data. The first method measures net foreign capital flows into the United States and shows the total accumulation of foreign direct investment over time. This is the Foreign Direct Investment Position and Balance of Payments Flows data series. The second method measures the total value of a U.S. affiliate's assets in which a foreign investor has an equity share

[1]For a more complete discussion, see Foreign Investment: Federal Data Collection on Foreign Investment in the United States, (GAO/NSIAD-90-25BR, October 3, 1989).

of at least 10 percent. This is the Operations of U.S. Affiliates of Foreign Companies data series.

In addition, another BEA data set, U.S. Business Enterprises Acquired or Established by Foreign Direct Investors, measures annual transaction values for new acquisitions of existing U.S. companies and for start-up investments. Finally, the Benchmark Survey of Foreign Direct Investment in the United States, comprising all three data series, provides more detailed information every 5 years.

Usefulness and Limitations

Each of these data series is useful in capturing a different aspect of the total investment picture; however, each also has limitations inherent in its methodology.

The following hypothetical case is a simplified example of how the three data series capture a different aspect of foreign direct investment transactions. Let us suppose that ABC Company of the United Kingdom makes an initial investment in the XYZ Company in the United States. ABC Company pays $100 million to buy a 50-percent share of the XYZ Company, which has a total worth of $200 million. Its transaction is structured so that it raises $50 million in the United Kingdom, and another $50 million is borrowed in the United States through a U.S. affiliate. The balance of payments data series would report the $50 million capital inflow from the United Kingdom; the enterprises acquired or established data series would report the $100 million investment outlay; and the affiliates data series would report the $200 million company as a foreign affiliate.

While the BEA data series help to piece together the foreign investment picture, there are important gaps and disparities in available data. For instance, the balance of payments data provide information about the amount of foreign funds that come into the United States, but they are not designed either (1) to capture the amount of the total investment transaction if funds from U.S. sources are used or (2) to identify the ultimate beneficial owner. These data also are based on book value, the value of the investment when it was initially made.

The data on enterprises acquired or established provide information about the total investment outlay or transaction cost, but only for new investments in that given year. If an existing investment is expanded in the following year, it would not be captured. This data series also classifies investments under the primary line of business of the new enterprise, unlike the balance of payments or affiliates data series, which classify investments under the line of business of the foreign investor. This classification difference means that the data on enterprises acquired or established cannot easily be compared to the other data series on a sector basis.

The most detailed of the data series, the affiliates data, provides information about the value of the total asset in which the foreigner has invested. Because these data include all firms that have more than 10-percent foreign interest, the question arises as to what portion is held by relatively small foreign equity interests in U.S. firms. BEA data showing the affiliates' sources of funds, however, indicate that foreign firms hold about 80 percent of the equity in such firms. Therefore, using the 10-percent equity interest rule to define foreign direct investment does not particularly distort the investment data. One exception is in the reporting of Japanese interests in the nonbank finance sector, where Japanese firms have purchased minority interests in U.S. securities brokerage or investment firms, which have very large assets relative to equity.

Unlike the balance of payments data, the affiliates data do include the U.S.-financed portion of the investment and attempt to report the country of the ultimate beneficial owner. Finally, due to the detailed information collected, which includes balance sheet items and statements of income, these data take longer to be reported, checked, and compiled: preliminary data are 2 years old by the time they are publicly reported, and revised data are 3 years old.

General Problems

This brings us to the subject of the general problems in the BEA data.

1. Timeliness - BEA publishes the preliminary balance of payments and new enterprises data about 6 months after the end of the report year. It should be recognized that BEA does publish these data on a timely basis. However, because of late reports and corrections, the revised data published in the subsequent year have often reflected significant changes. Timeliness is an issue with regard to the affiliates data, which is, however, the most detailed data series.

2. Classification methodology - The data are limited by the industrial classification system used. This is roughly based on the three-digit Standard Industrial Classification (SIC) level, which BEA feels is the lowest level to reasonably classify enterprise data. BEA does not require greater detail in identifying industrial classification in company reporting. This means that many important industry sectors are not listed separately, including numerous sectors vital to national security, such as aerospace and semiconductors.

3. Consolidated reporting - Data are reported on an enterprise rather than an establishment basis. In other words, the U.S.

affiliate corporation files a single report for all of its assets, including its own subsidiaries. For example, a U.S. petroleum corporation with foreign ownership interests may own many subsidiaries in varying industry sectors, each one of which may have many establishments (which can be individual factories or properties). But it will file one report for the whole enterprise, all of which will be classified under the petroleum sector by BEA. This can skew the data in all sectors. Although establishment-level data are needed for adequate analysis of important public policy questions, BEA collects only limited data on sales and employment below the enterprise level. According to BEA, collection of more industry detail below that level is constrained by the requirements of the Paperwork Reduction Act to minimize the burden on respondents.

The BEA and the Census Bureau are currently working on establishing a data link between their databases. Census data contain detailed individual establishment-level information but do not highlight foreign ownership, while BEA tracks foreign ownership but collects only enterprise-level data. A pilot project is underway to use the firms' Internal Revenue Service Employer Identification Numbers to match the BEA enterprise data to the Census establishment data. Commerce could then publish these new data annually at an aggregated level. Even in aggregated form, the data would provide greater sectoral breakdowns (such as for aerospace or semiconductors) and at least partially address the classification and consolidation problems discussed above. The objective of this new data set is to have more reliable and detailed information on foreign direct investment without placing a greater burden on the private sector. Achieving this will require overcoming technical problems and obtaining additional resources.

4. Access to data - The individual firms' reports are confidential. Access to this information is statutorily limited to officials specifically designated by the President to perform analytical and statistical functions under the International Investment and Trade in Services Survey Act of 1976. Only aggregated data are released outside of BEA. This limits others with a legitimate need to know from examining the data to further track foreign direct investment in specific industry sectors. It also results in substantial data suppression in the state-level data in order to protect the confidentiality of respondents, who could be identified when the number of affiliates is small.

GAO ACCESS TO DATA

The legislative branch needs to be fully informed about the nature, extent, and effects of foreign direct investment in the United States. Proposed legislation providing GAO access to foreign direct investment data that is otherwise restricted would be consistent with GAO's mission and appropriate and beneficial to legislative branch oversight in this area. Providing GAO access to these data would allow it to perform such evaluations for the Congress and to assess the adequacy of federal government data on foreign investment.[2]

The issue of safeguarding the confidentiality of data should be separate from the issue of who should have access. Access should be determined on a need-to-know basis. Confidentiality of data is safeguarded by the procedures for gaining access and handling, and by regulations prohibiting unauthorized disclosure, not by unnecessarily restricting access.

We believe that GAO should have access to foreign direct investment data for the reasons I have just stated. We also note that GAO has in place strict and rigorous programs to maintain the security and confidentiality of information consistent with the requirements of the originating agency.

GAO conducts many reviews of agency programs that necessitate access to confidential, proprietary, sensitive and, in many cases, highly classified information. We routinely have access to national security information of the utmost sensitivity. We also routinely have access to proprietary information more similar in

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[2]This issue is discussed in greater detail in our June 13, 1990 testimony, National Security Review of Two Foreign Acquisitions in the Semiconductor Sector (GAO/T-NSIAD-90-47).

nature to the foreign direct investment data, such as that acquired by federal bank authorities in regulating bank activities. In addition, GAO has access to Internal Revenue Service tax data, including files that show names and social security numbers. In all these cases, procedures are in place that are designed to prevent unauthorized disclosure.

In summary, GAO has been entrusted with access to much of the most sensitive data held by the federal government and has an excellent record in safeguarding such data.

MORE THAN IMPROVED FOREIGN INVESTMENT DATA IS NEEDED TO ANSWER SOME IMPORTANT QUESTIONS

I would like to point out that there are also some important questions about foreign investment that cannot be resolved by improving foreign investment data.[3]

In the banking sector, for example, Federal Reserve Board data are comprehensive and publicly available. Specific transactions and foreign investment trends can be identified, showing that foreign investors hold over 25 percent of U.S. banking assets. What is not clear, however, is whether there is some level of foreign ownership

[3]For a detailed discussion of these issues, see Foreign Investment: Concerns in the Banking, Petroleum, Chemicals, and Biotechnology Sectors (GAO/NSIAD-90-129, May 30, 1990).

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beyond which foreign control would be undesirable. For example, could lending decisions affecting the growth and direction of U.S. industry be subordinated to foreign interests? The type of data needed for this analysis would be information relating, for example, to bank lending patterns and competitive behavior.

In the petroleum sector, the Departments of Commerce and Energy have detailed data showing the extent and nature of foreign investment, and it is known that members of the Organization of Petroleum Exporting Countries have invested in U.S. refining and marketing facilities. The difficult question is whether such a link enhances security of petroleum supplies or raises the risk of greater U.S. vulnerability to events in the Middle East. Analysis of this question needs to focus both on finding ways to reduce the likelihood that OPEC member countries would choose to exploit any vulnerability and on reducing that vulnerability. For petroleum, of course, it should be recognized that the basic issue is U.S. dependence on oil imports and that the potential for disruption exists regardless of foreign investment levels.

In the biotechnology sector, formal government data cannot be disaggregated to show foreign investments, but private sector data can identify trends indicating increased foreign participation in the U.S. biotechnology industry, particularly by Japanese firms. The central question in this sector is whether the short-term benefits from such investment will match the consequences of transfers of core technologies, including the benefits from commercializing them. Answers to this question would have to come from a closer government focus on the direction and types of technology transfers that are occurring. Indeed, the key question is the basic public policy question of whether the U.S. government should try to ensure that commercially strategic technologies originating in the United States are developed by U.S. firms into commercial products.

With regard to national security concerns[4] about foreign acquisitions of U.S. firms, we found that the most difficult questions posed by individual investments required (1) identifying the U.S. firm's link to national security and (2) assessing foreign investor intentions regarding technology transfer, assured supply to the Defense Department or its contractors, and the security implications of any commercial advantages gained through the investment. Improved foreign investment data cannot answer these questions, which are frequently raised in the interagency review process for national security-related investments, as provided in the 1988 Exon-Florio Amendment to the Defense Production Act.[5]

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[4]For a detailed discussion of these concerns, see Foreign Investment: Analyzing National Security Concerns (GAO/NSIAD-90-94, March 29, 1990).

[5]These issues were also covered in our June 13, 1990 testimony, National Security Review of Two Foreign Acquisitions in the Semiconductor Sector (GAO/T-NSIAD-90-47).

From a macroeconomic point of view, we should recognize that the United States is experiencing increased foreign participation in the U.S. economy in part because U.S. budget and trade deficits require foreign capital to finance them. As long as U.S. domestic savings fail to match federal budget deficits and private sector investment needs, the United States will be dependent on foreign financing. Therefore, foreign direct investment will remain one element of such foreign participation in the U.S. economy.

Overall, we believe improvements can be made in the government's foreign investment data, but we also believe the nation's highest policymakers need to address some of the more difficult questions raised by increased foreign investment in the United States.

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This concludes my statement, Mr. Chairman. I will be happy to try to answer any questions the Committee may have.