Foreign Investment in U.S. Real Estate: Scope and Policy Issues

by Milton A. Berger

United States policy toward foreign investment in real estate has to be examined within the context of the general policy toward foreign investments here.

The guiding principle behind the international investment policy of the United States and other major industrialized nations has been that free market forces should determine the direction of capital flows throughout the world to maximize economic efficiency. The general premise that resources should be permitted to move internationally to their greatest economic usefulness applies equally to our trade policy. This policy recognizes that no nation can be self-sufficient, that we live in an economically interdependent world. Trade and investment barriers can deny us jobs, income, goods, and technology. We export 23% of our farm output and 8% of our manufactures. We import far more raw materials than we export. Our enterprises abroad account for a substantial part of our exports, provide us access to important raw materials, and are a critical factor in world economic development—so important to our own economic and political security. Foreign-owned enterprises here provide employment, increased income, new products, and new technology.

THE OPEN DOOR POLICY

The United States policy on inward investments from abroad is an open-door non-discriminatory policy. They are admitted freely and foreign investors are treated on the same basis as domestic investors. They are offered no special incentives to attract them to the United States and, with few exceptions, they are confronted with no special barriers. The few exceptions to this open-door policy involve limited federal restrictions on foreign investment in certain sectors of the economy which have a fiduciary character, such as banking, or relate to the national interest, such as communications and transportation, or

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involve the exploitation of natural resources, such as mining on federally-owned lands. In addition, some states impose restrictions on foreign investments, particularly in banking, insurance, and land ownership.

This general policy, which has prevailed over the 200 years of our republic, and which was responsible for much of our early economic development, was not seriously questioned until very recently.

However, about three years ago some apprehension about foreign investments here began to be manifested around the country. There was concern about concentration of foreign investment in certain areas and in certain fields, such as hotels in Hawaii. Dollar devaluations and the depressed value of shares of stock of U.S. companies made both investments in new facilities and acquisitions cheaper and more appealing to potential foreign investors. There were fears of significant foreign acquisitions of agricultural land and natural resources. And then the Middle East oil-producing countries emerged with massive amounts of petrodollars looking for uses. With most of these reserves held by the governments of these countries, many Americans were fearful they would make huge politically-motivated investments, taking over major firms and even industries and subjecting the U.S. economy to external political pressures.

These concerns were reflected in a number of bills in Congress to register, review, and control foreign investments here. The Administration has opposed the various measures that would impose any screening procedure or establish new barriers to such investments on the grounds that the scope, character, and motivation behind foreign investments do not justify such measures. However, the Administration agreed with the Congress that our knowledge of these activities was insufficient and that more data needed to be developed and analysis made to make sure that our policies were supported by the facts.

FOREIGN INVESTMENT STUDY ACT

In October 1974 Congress passed and the President signed the Foreign Investment Study Act which required the Commerce and Treasury Departments to conduct very intensive studies of foreign direct and portfolio investment in the United States and to deliver reports to the Congress within a year and a half. This June the Commerce Department submitted a nine-volume, 2,500-page report to the Congress. The principal findings are of interest to the real estate community.

Investors Named

First, we found that the foreign direct investment position in the United States was $26.5 billion at the end of 1974, the period of our statistical survey. It is now over $30 billion. Foreign direct investments are those where the foreign party owns 10% or more of the voting shares of a U.S. business enterprise. The foreign direct investment position is a net figure, setting off claims between foreign parents and their U.S. subsidiaries. The United Kingdom, Canada, and the Netherlands each account for about one-fifth of the total. Statistically Japan's interest is small, because of the very substantial loans the subsidiaries here make to their Japanese parents, but in fact the Japanese interest is quite significant. Of all foreign investments here, Japanese subsidiaries account for one-fifth of their assets, two-fifths percent of their exports, a third of their imports, and a quarter of their total sales. While there is much speculation about Middle East investments here, we found that their interests represent a tiny fraction of foreign holdings of enterprises operating in the United States.

What kinds of investments do foreigners make? About one-third is in manufacturing—mainly chemicals, food and machinery. Another one-fourth is in petroleum and still another one-fourth is in the category of finance—mainly banking, insurance and real estate. Most of the rest is in wholesale trade.

Foreign-Owned Land

What did we find out about foreign ownership of real estate? As you know, beneficial ownership of land is often difficult to identify, and land recordation systems are generally not very demanding in this respect. The 1974 statistical survey required U.S. business enterprises, whenever at least 10% directly or indirectly foreign-owned, to file reports. If the enterprise was in the nature of real property not identifiable by name, the report had to be filed by the foreign beneficial owner or his representative. The survey provided us with real estate information in two forms—acreage owned and leased and the dollar value of a broader category, namely plant, property, and equipment.

According to the returns received, foreign-controlled business entities owned 4.9 million acres of land at the end of 1974. Slightly over 1 million acres was in agricultural land, only about 0.1% of the 1.1 billion acres of U.S. land in farms; 1.3 million acres were used in connection with manufacturing enterprises; 900,000 acres were in the real estate industry; 500,000 acres were owned by foreign-owned petroleum firms; and 1.2 million acres were held in an "all other" category which includes hotels, resorts, golf courses, timber, and mining other than petroleum.

In addition, foreign-owned U.S. enterprises leased 62.8 million acres of land. However, about half of the acreage leased was located abroad. Much of the remainder consisted of offshore mineral rights.

U.S. affiliates of firms in the European Economic Community—predominantly in the United Kingdom—accounted for two-thirds of the total of the foreign-owned land covered by the survey. Canada accounted for another quarter of the total.

Value of Holdings

The total value of property, plant, and equipment held by foreign-owned firms was $45.6 billion. It should be borne in mind that a substantial amount of the equipment would not be categorized as real estate. Property, plant, and equipment in agriculture and timber activity was valued at $491 million; in crude petroleum production at $8.4 billion; in other natural resources at $2.4 billion; in transient lodging, residential, and recreational activities at $1.7 billion; in industrial activity at $19.7 billion; and in other commercial and business activities including, among others, shopping centers and office buildings, at $10.7 billion.

In addition to the 1974 statistical survey information on foreign land ownership, the Commerce Department augmented its report to the Congress with 21 studies on a broad range of issues relating to foreign ownership of agricultural land and other real estate in the United States. These studies were carried out by economists, political scientists, sociologists, and lawyers from several universities and research organizations under the direction of the Department of Agriculture's Economic Research Service, with Commerce Department sponsorship. They are substantially reproduced in the report to Congress.

Still another analytical effort dealt with state and federal law affecting foreign investments in land. The findings were that land or property law is primarily state law. Few states have substantial restrictions on alien ownership of land. Most either treat aliens on an equal footing with citizens or they impose nominal restrictions. Several states have general prohibitions, but a variety of exceptions narrows their application and the general effect is to prohibit only the individual investor living abroad from purchasing agricultural property in his own name. Some states limit the acreage which a non-resident alien can own; others limit the period during which an alien may hold land. Aliens may avoid some of the restrictions by commonly-used disclosure avoidance techniques. Federal law establishes ownership requirements for certain uses of the public domain.

EVALUATING FOREIGN INTERESTS

What is the overall significance of foreign investment in the U.S. economy? It is important but is for the most part a minor factor in the various economic categories.

Foreign-owned manufacturing facilities account for less than 6% of the nation's output in each of the broad industry categories, although higher in some subsectors. For instance, these investments are fairly important in newsprint and several chemical industries—dyes, pharmaceuticals, and synthetic fibres.

Foreign-owned affiliates account for about 7% of our petroleum output. They have about 6% of our total bank assets and they account for about 5% of total insurance premium income. Foreign participation is not large on a national scale in non-energy minerals, forest resources, and the commercial fisheries industry, but the foreign presence is significant locally in some cases.

Why do they invest here? First is the pull of the large U.S. market, relatively favorable labor conditions, and the availability of raw materials and special technologies. Second is the push of comparatively less favorable economic conditions abroad and the increased financial, technological and managerial strength of foreign companies. Equalization of U.S. labor costs with those abroad and dollar devaluations have been important accelerating factors in recent years. The relative political stability of the United States is also a major attraction.

What about the financing, management, labor, and other business practices of foreign investors here? In the initial stages they tend to turn to foreign sources of funds. Later they make substantial use of the U.S. capital markets.

The degree of influence of the parent firm varies, reflecting parent company policies and the character of the operations. The parent companies are generally involved in major financial decisions, but production, marketing, and labor practices are largely decided at the U.S. subsidiary level. U.S. citizenship is held by 95% of the employees of foreign-owned firms, including the major share of managerial personnel. On the whole, these companies also adapt to U.S. business practices. Although hard data are not available on the role of foreign-owned firms respecting international flows of technology, we came to the conclusion from our inquiries that on balance the flow of product and process technology is into the United States, while in the area of management innovations and marketing techniques the net flow of technology seems to be outward.

ECONOMIC CONSEQUENCES

What about the economic effects of these foreign investments? While they are significant in size and scope, they are a relatively small factor in the nation's economy. Massive foreign takeovers of U.S. industry have not occurred and are not looming. Tracing all the consequences of foreign direct investment on the domestic economy is extremely difficult. In most respects they are generally beneficial to the nation in the same way as similar domestic investments. Both can create jobs, enlarge the nation's productive capacity, expand the availability of products, and stimulate competition. Foreign investments do have different international economic effects. They tend to strengthen our balance of payments in the short run through capital inflows and reinvested earnings. In the long run these are partially offset by remittances of earnings to the parent companies. Trade effects can be both positive and negative and differ from the short term to the long term. Factors involved are the degree of displacement of imports of finished products, imports of materials and capital equipment, and the extent the U.S. subsidiary markets its products abroad. Thus determining the long-term balance of payments effects of any individual foreign direct investment, let alone the aggregate effect of all such investments, cannot be readily accomplished. But their real significance is in broader terms. Foreign direct investments are only one element in our international accounts. More meaningful is that the inward flow of foreign investments reflects our policy of welcoming such investments. This policy is an important factor in the readiness of the other countries to treat our investments abroad favorably. Such investments are four and one-half times as large as foreign investments here. In 1974 they accounted for more than $20 billion in various forms of income.

Given these findings, the Commerce study concluded that a shift in policy toward increased restraint could be detrimental to the U.S. economy and to our relationships with other countries, and that existing laws and policies provide adequate protection of our national interests. The major recommendation was that we maintain surveillance over these investments through improved data gathering and analysis. This is the function of the Office of Foreign Investment in the United States in the Department of Commerce and of a Cabinet-level Committee on Foreign Investment in the United States. Neither function involves screening or restraints on individual investments.

IMPLICATIONS OF CURRENT LAWS

As we come to the close of 1976, we find that no new laws have been passed restraining foreign investments in the United States. The only new legislation bearing on foreign investment is Public Law 94-472, the International Investment Survey Act. This law, which was supported by the Administration, strengthens the Executive Branch's authority to collect foreign investment data on a mandatory response basis. It generally defines the content of a required data collection program. It provides for the preparation of statistical surveys and other studies on both inward and outward foreign investment, with the statistical studies to be produced at least every five years. Reports are required to the Congress and for general publication.

Finally, reflecting the continuing dissatisfaction with the scarcity of knowledge about foreign investment in real estate, the new law calls for a study of the feasibility of a system to monitor foreign direct investment in agricultural, rural, and urban real property, including the feasibility of establishing a nationwide multipurpose land data system. A report is due in two years.

Thus, in conclusion, while current policies provide for generally non-restrictive treatment of foreign direct investments, and while comprehensive studies have supported this policy, a new dimension has been added through administrative order and legislation in the form of on-going monitoring and analysis of such investments. Means to record foreign real estate ownership are to be intensively examined. The real estate industry has an important stake in future foreign real estate investments. It is uniquely equipped to contribute to a balanced assessment of the feasibility and desirability of a special monitoring system for such investments.