VOLUME 20, NUMBER 2, SPRING 1979

Book Reviews

A Reply to *American Multinationals and American Interests**

HAL S. SCOTT†

This book, which promises to be influential, performs the worthwhile task of assessing existing United States policies affecting multinationals. The book contains much useful background on our present policies and offers original research in a number of areas, such as the relationship between United States exports or United States firms' domestic market power, on the one hand, and foreign investment, on the other. Most importantly, it contains some rather specific suggestions for future policies. This review appraises these policy prescriptions, which can be summarized as follows: (1) discourage equity investment and encourage debt financing in natural resource projects; (2) repeal deferral for income of foreign subsidiaries, substitute a per-country limitation for the overall limitation on the foreign tax credit, extend investment credit and accelerated depreciation range allowances to foreign investment, and repeal advantages for Domestic International Sale Corporations (DISCs); (3) encourage split-off of foreign subsidiaries of domestic firms found to monopolize the United States market and extend the permissible scope of antitrust attack on intracorporate conspiracies; and (4) establish an "escape clause" to compensate those persons, firms, and communities negatively affected by foreign investment abroad or to halt entirely certain foreign investments adverse to United States interests.

The most troubling aspect of the book, apart from the merits of specific recommendations, is the failure to identify a coherent definition

*By C. Fred Bergsten, Thomas Horst & Theodore H. Moran. Washington, D.C.: The Brookings Institution, 1978. Pp. 535. $18.95.

†Assistant Professor, Harvard Law School.

of United States interests. I am afraid that this review is not the place for me to formulate and defend a more coherent set of views or policies about United States multinationals. I am not even sure this is worthwhile. Policy toward multinationals, domestic or foreign, is a side issue; one should be formulating policies on investment, tax, trade, and antitrust policy with other more fundamental questions in mind, such as perfecting or regulating markets and distribution of the world's goods.

EQUITY INVESTMENTS IN NATURAL RESOURCES

One major and recurring concern of the authors is with the consequences of United States equity investment in natural resource projects abroad. They describe the failure of the attempt by western governments to use foreign investment in natural resources as a means of controlling needed access to output. The success of that attempt depended on a world in which host governments permitted investors to respond to the demands of the home country. According to the authors, this world, which existed for the first five or six decades of this century, has ceased to exist due to the increased power and ideological shifts of countries rich in natural resources. This has, in turn, led to the phenomenon of the "obsolescing bargain," in which host countries seek to renegotiate the terms of investments once they prove successful.

This process, previously described by Vernon,[1] produces a scenario in which a foreign company is initially enticed by favorable terms, such as tax holidays, that outweigh drawbacks of committing large lump sums of capital under conditions of great uncertainty. Once the uncertainty is dissipated and the project proves profitable, original terms appear to host governments to be overgenerous, and the company, which cannot withdraw without losing its investment, must accept stricter terms. These new bargains, too, may become obsolete as conditions again change. The authors believe that the obsolescing bargain has meant a larger share of returns from the extractive sector for host governments and has insured them effective control over price and marketing policy, as well. They acknowledge that only competition and increased sources of supply will restrain host countries in fixing prices and exercising increasing control over investment terms; and they believe that large equity investments are particularly vulnerable to either nationalization or heavy taxes.

The authors believe that the obsolescing-bargain phenomenon may discourage new investments and thus discourage increased competition. It may also lead to confrontations between home and host countries as United States corporations, subject to renegotiation or expropriation,

1. R. VERNON, SOVEREIGNTY AT BAY 46–59 (1971).

seek protection and support from home. United States support, as through trade restrictions, though ultimately ineffective, leads to further confrontation. While the creation of that source of tension is within United States control and is subject to elimination, the authors urge us to deal with the underlying problem: "direct ownership of foreign natural resources by American companies that have no viable method of defending themselves once they have sunk hundreds of millions of dollars in a successful operation." [2] The recommendation is that United States policy should promote the "unbundling" of corporate services, such as managerial experience, production technology, and marketing expertise from the provision of capital.[3]

While the authors recognize that technology supply contracts will not offer an economic return on a foreign equity investment, they believe the return is illusory anyway due to the obsolescing bargain. Management and service contracts can, of course, also be subject to renegotiation, but the companies are viewed as adapting more easily to this than renegotiating returns on equity. The argument is that these kinds of contractual arrangements generate less tension because they avoid the sensitive issue of foreign ownership of subsoil rights. Further, since the companies would retain control over their technology assets, which is not the case with capital, their exposure would be less dangerous and their bargaining position would be improved.

There is still a need for capital to finance the development of natural resources. The authors envision that such capital would be supplied in the form of loans from future customers and/or banks. Banks could lend directly to a development subsidiary owned either by the United States investor or host country or as a joint venture, or to customers against the security of their supply contracts. Both the customers and the banks could apparently look to the equity of the development subsidiary (there is no mention of parent or government guarantees) in the case of default.

How could the United States promote a shift from equity to debt financing? One recommended tool is a change in present taxation of foreign income of United States extractive multinationals. While earnings from nonequity contracts would continue to be eligible for the full foreign tax credit, earnings on equity holdings would gradually be made ineligible. Also, firms using equity investment would be restricted to a per-country tax credit limitation. Equity investors would thus have

---

2. C. Fred Bergsten, T. Horst & T. Moran, American Multinationals and American Interests 393 (1978) [hereinafter cited as American Multinationals].

3. *See also* Moran, *Transnational Strategies and Defense by Multinational Corporations: Spreading the Risk and Raising the Cost for Nationalization in Natural Resources*, 27 Int'l Org. 273 (1973).

excess tax credits when taxes paid to the producing country exceeded 46%. Management service subsidiaries could continue to average tax rates from different countries through use of the overall limit. A second recommendation is that Overseas Private Investment Corporation (OPIC) insurance would be unavailable for such equity investment; OPIC could, however, guarantee debt obligations. Presumably, the authors would not proscribe private insurance for equity, although this is unclear.

The major benefits claimed to result from this approach would be reduction in tensions between the United States and host countries over renegotiation or expropriation of direct foreign investment in natural resources, and promotion of increased investment and development of resources, with the possibility of lower prices following from increased competition and multicountry supply. Diversification of supply would also impede successful cartels.

The most that can be said for the proposal is that it is original. Capital must still be supplied to develop a project and return on such capital investment, whether in the form of debt or equity, will be demanded by the capital supplier. The authors have merely shifted the type of capital from equity to debt. The risk of supplying that capital will be compensated in interest rates. When the project proves successful, pressure will be exerted by host governments to reschedule the debt return, such as by change in terms for repayment or interest rates, in the same fashion that demands have previously been made to reschedule the equity return. Indeed, the pressure to renegotiate debt obligations, which are fixed foreign exchange obligations, may be irresistible for a country with balance of payment problems. If the capital has been loaned to a development company, the failure of that firm to secure repayment by the host country will lead to possible default on obligations to banks and customers. This will require the capital suppliers to permit the company to reschedule its debt obligations or to face default. The assets of the subsidiary are unlikely to cover the debt.

In fact, given the possibility of such rescheduling or default by the host government, it is unlikely that the customers and the bank will rely wholly on the development company's assets to secure their loans, thus leading to a claim under a prearranged guarantee against the assets of the parent(s) if the development company is privately owned. This possibility will once again lead to tension between the parent(s) exposed on the guarantee and the host government and, additionally, promises to involve banks or customer capital suppliers in such confrontation. If the development company has sought to secure its loan to the foreign participants by national resources produced by the project, we are plunged once more into the subsoil sovereignty issue, in the context of

attempted foreclosure on a security interest. As before, the home government's protection will be sought by parties subject to the debt rescheduling and political tension will again arise. To the extent that such uncertainties reduced the willingness of parties to finance development of natural resources, the increased supply of such resources would be no greater under debt financing than it was under equity financing. Indeed, one can argue that the potential domestic impact of such an event on the banking structure would be more serious than under equity arrangements, where the adverse impact of renegotiation or expropriation is limited to the shareholders of the equity supplying company. It is ironic that this proposal should be made during a period when the Federal Reserve Board has become more concerned with the country risk of banks lending in the international area.

While tension might arguably be decreased (to the extent it really exists) by removing OPIC guarantees under both equity and debt arrangements if OPIC became involved in securing the debt repayments, the debt alternative would involve the United States no less than the equity alternative. In my view, however, OPIC insurance relieves tension by its presence, and withdrawal of such insurance would lead to increased tension between the investor and the host country, and ultimately the United States and the host country. One central result of risk spreading should be to defuse confrontation.

While the authors suggest that part of the tension might be decreased by assuring that there were multiple and multinational sources of debt financing, this prescription could be equally applied in the equity situation by requiring multinational and diverse sources of equity investment.[4] The risk of renegotiation or expropriation is less when the equity or debt supplied is multinationalized since the developing country must face a number of developed countries responding negatively to its actions, but this is not an argument for debt rather than equity financing. One could argue that the host country will be less willing to jeopardize credit suppliers, especially if they are prominent multinational lenders, than they would be to jeopardize particular equity investors. However, there are many sources of debt finance and the alternatives available will strengthen the hand of the host country. Recognition of these facts will tend to restrain the supplier from actually declaring default on the loan.

More fundamentally, the authors may have overrated the impact of investment renegotiations on United States investors and the United States. To begin with, the number of actual expropriations of major

4. D. Nedjar, Political Risks and Foreign Investments in the Seventies: Corporate Planning and Government Policies (1977) (unpublished S.J.D. thesis in Harvard Law School Library).

consequence in the last fifteen years has not been substantial when viewed in the context of total foreign direct equity investments in natural resource projects.[5] Second, companies today fully understand the nature of the obsolescing bargain and will discount the negative impact of expected renegotiations in the initial terms of their foreign investment. For example, they may seek to recover their investment faster at a higher rate of return to compensate for the expected lower rates of return in later years if the project proves successful. To assume otherwise would be to posit that United States investors act in an irrational fashion. Investment in the normal context is subject to a great number of risks, and renegotiation risk will be priced like all others. Given this analysis, investing companies should be left free to determine the mix of debt and equity that they wish to use in financing natural resource projects and the tax system should not be used to discriminate between advantages attaching to such choices.

INTERNATIONAL TAX CHANGES

The authors put forward a second set of recommendations in the international tax area which are less original but equally problematic. They would repeal deferral for income of foreign subsidiaries, eliminate the overall foreign tax credit limitation and replace it with a per-country limitation, extend the investment credit and accelerated depreciation range (ADR) allowances presently available for domestic investment to foreign investment, and repeal DISC advantages.

By way of background, the authors found that whether one looks at taxes payable or taxes payable plus taxes deferred of foreign subsidiaries of United States parents, foreign taxes as a percentage of foreign book income usually exceeds United States taxes, after foreign tax credits, as a percentage of United States book income. The authors attempted to account for this finding. Using a weighted average of twenty-four countries' realized tax rates (fifteen developed and nine undeveloped),

5. One study estimates that 511 acts of involuntary disinvestment occurred in 76 developing countries between the years 1960–1976. This resulted in the takings of approximately 1195 firms, or 5% of a very rough 1973 estimate of the total number of LDC subsidiaries of firms from the developed market economies. S. Kobrin, Firm and Industry Factors which Increase Vulnerability of Foreign Enterprise to Forced Divestment: A Cross-National Empirical Study 8 (1978) (Working Paper, Sloan School of Management). Only 40% of such takings involved United States owned subsidiaries. *Id.* at 28. However, the trend of involuntary divestment accelerated over time. 30% of the divestments in the 1960–1976 time period occurred in 1974–1975 alone. *Id.* at 9. In terms of value of the takings, it has been estimated that gross expropriation of United States property in the less developed countries from 1965–1970 was 3.2% of the total value of United States foreign direct investment. Hufbauer & Brigg, *Expropriation Losses and Tax Policy*, 16 HARV. INT'L L.J. 533 (1975). These statistics, of course, are highly dependent on the definition of expropriation used.

based on total earnings from each country, the authors report that United States owned manufacturing affiliates paid foreign taxes averaging 43.8% of their pretax income (as determined by United States standards) in 1968, which was less than the prior 48% *statutory* rate in the United States. They concluded that United States corporations might have a weak incentive to allocate taxable income to foreign affiliates. However, the high income and withholding taxes in Canada and most countries in Western Europe discourage allocating income for tax purposes to these affiliates, whereas the low tax rates in certain (particularly developing) countries may lead to such allocation. Yet, given the further advantages to domestic investment by way of the investment tax credit, ADR and DISC, the authors conclude that "despite the wide spread view that current U.S. tax policy encourages American corporations to allocate income and investment to overseas affiliates, that bias is true only in exceptional cases." [6]

Deferral

The authors then turn to specific recommendations for tax reform, beginning with the repeal of deferral.[7] Given the disparity between the effective foreign and statutory United States tax rates, they estimate that repealing deferral might cost United States investors 5% to 6% of their foreign affiliates' earnings, as of 1974, since effective tax rates would move from between 42% and 43% to 48%. Given the decrease in the current United States statutory rate to 46% and possible increases since 1974 in overseas rates, this calculation may be dated and the deferral advantage or cost of ending deferral overstated. The authors recognize that this kind of prediction must generally be adjusted for two factors: the actions multinationals and foreign governments might take in response to the repeal.

As for the first factor, the authors develop a model of investment behavior to simulate the impact. Since eliminating deferral raises taxes on foreign affiliates' income, investors become less willing to invest overseas. Domestic investment will be substituted for foreign investment whenever the tax burden on the latter is increased. Furthermore, higher taxes will leave firms with lower investible funds worldwide, even taking into account increases in borrowing. They estimate, based on 1974 statistics, that United States investment would rise by $1,429

6. AMERICAN MULTINATIONALS, *supra* note 2, at 195.

7. Deferral results from the fact that a United States corporation is not usually taxed on foreign corporation earnings until it receives them as dividends. Dividends are only received when the cost or other property is unqualifiedly made subject to the demands of the distributee. Treas. Reg. § 1.902-3(g).

million, or 3.9% of actual value while new foreign investment would fall by $1,549 million or 8.5% of actual value. The impact on the capital outflow from the United States parent to its foreign affiliates of eliminating deferral is somewhat larger ($120 million) than its impact on foreign or domestic capital formation. This reflects the assumption that United States investors would finance more of their foreign investment, and less of their domestic investment, with locally borrowed funds.

The principal beneficiary from such a change would be the United States Treasury — with gains of $566 million. Foreign affiliates' retained earnings would be taxable and domestic investment and income stimulated. The biggest losers would be the United States multinationals whose consolidated after tax earnings would have been reduced by roughly the increase in United States taxes. The other losers would be foreign governments, since foreign income and withholding taxes would fall because foreign investment was cut back, and foreign borrowing increased, as a proportion of the remaining investment. The authors point out that the gains to the United States Treasury are outweighed by the combined losses to the domestic investors and foreign treasuries.

As for the second factor, the authors recognize that foreign governments might react to the repeal of deferral and the potential loss of tax revenues by raising their corporate tax rates to the level of the United States. The host countries could even retaliate by treating the total earnings of United States affiliates as presumed dividend distributions and thereby subjecting them to the dividend withholding tax. This would result in the foreign governments capturing a significant portion of the $566 million tax gain attributed initially to the United States, absent such retaliatory action.

Despite the acknowledgment that repeal of deferral may not lead to increased United States revenue gain, and may lead to less investment in the aggregate, the authors still support repeal by reference to the principle of capital export neutrality. While the authors state that deferral gives foreign investment only a small advantage, offset by the denial of the investment tax credit and ADR availability, they emphasize that the retained earnings of an affiliate in a low tax country avoid United States taxation through deferral, since its dividends are sheltered by excess tax credits from high tax countries. The authors therefore claim that assertions of "aggregate" neutrality have a hollow ring. Of course, this cross-subsidization might be limited by changing from an overall to a per-country foreign tax credit limitation, a separate recommendation upon which I shall comment below; nonetheless, they still favor the elimination of deferral.

The authors give the following reasons in an early part of their book as to why this change should still be made:

> The political controversy over multinationals is heightened by the widespread belief that U.S. tax policy implicitly encourages American manufacturers to export jobs, and although that belief is largely unfounded, exceptions do exist. Some investors do have strong tax incentives to invest in low tax countries, and those incentives would be largely eliminated by the tax changes we propose. Furthermore, the deferral of U.S. taxes on foreign source income helps justify domestic international sales corporations, which serve little purpose in a world of flexible exchange rates. Finally, as long as deferral is granted manipulative transfer pricing is encouraged, and tax havens must be attacked with cumbersome rules defining base company income.[8]

In my view, the way to deal with a mistaken belief about the impact tax policy has on encouraging United States manufacturers to export jobs is not to give it additional credence by ending deferral, but to attack the belief directly. General tax policies should not be shaped to deal with limited exceptions. As for incentives to invest in low tax countries, these might be decreased by adoption of the per-country limitation; in any event, one must ask what is wrong with the promotion of such investment, given the possibility that elimination of deferral would generally lead to a net decrease in all investments and no gain for the United States Treasury. Sham investments in low tax countries can be dealt with through Subpart F,[9] so what we are concerned with here are legitimate investments in low tax countries. While Subpart F may be cumbersome, this hardly seems an adequate justification for ending all deferral — indeed, any complicated set of tax rules is cumbersome. At a later point in their book, the authors envision permitting deferral for certain investments in developing countries, to encourage development of resources and other ventures. It is thus somewhat disingenuous to use an argument against encouraging such investments to support repeal of deferral.

The authors' quoted argument based on manipulative transfer pricing opportunities, encouraged by the effect of deferral in low tax rate jurisdictions, is a somewhat stronger argument, but such incentives will remain as long as deferral will be available for some countries. Further, local tax rates may differ even upon the elimination of deferral, and where such tax rates exceed those in the United States, manipulative transfer pricing incentives will still exist. United States investors will

8. AMERICAN MULTINATIONALS, *supra* note 2, at 211.
9. I.R.C. §§ 951–964.

still try to decrease their excess tax credit positions, particularly under the per-country limitation system advocated by the authors. Finally, if the problem is with DISC, then DISC can be eliminated and deferral retained.

In a later part of their book, the authors rely more upon the more abstract capital export neutrality argument.[10] While recognizing that United States laws today are more or less neutral in the aggregate, they stress that they may not be neutral in individual cases. Eliminating deferral is viewed as a critical first step toward eradicating the ability of taxes to divert new investment to low tax countries. Economically efficient behavior requires that investment decisions, as between domestic and foreign opportunities, not be guided by tax consequences. Again, however, they envision allowing deferral for certain investments in developing countries.

This view of neutrality has a decidedly ethnocentric bias. The argument assumes it is proper for the United States to tax income produced by foreign investment in the same way it taxes income produced by domestic investment. This assumption leads us to tax worldwide income of United States citizens and corporations. Application of this worldwide provision *without* deferral will lead to a result which is not neutral from the perspective of the host country. A host country with a 30% tax rate will have a situation in which investments made by domestic investors will be taxed at 30%, whereas investment produced by United States capital will be taxed currently at 46%, given the combination of the domestic and United States taxes involved. Home country capital export neutrality is at war with host country source of income neutrality, and it is far from clear to this reader which principle of neutrality should take precedence. Of course, ultimately the United States investor, upon remittance, may pay 46%, but deferral postpones this effect. This is particularly troubling when it is acknowledged that the increased rate of United States taxation might not increase United States revenue: what justifies the home country policy in such case?

The authors show sensitivity to this neutrality dilemma by acknowledging that deferral will remain for investments in certain developing countries: the purpose of ending deferral must then be to eliminate developed country tax incentives. Since most developed countries currently tax at United States rates or higher, one is singling out certain developed countries which do not display this kind of tax pattern, such as Switzerland. Why should not Switzerland be able to encourage investment in its country — legitimate investment which is assumed by the application of Subpart F — when the existence of such incen-

10. AMERICAN MULTINATIONALS, *supra* note 2, at 461–62.

tives does not harm the United States in the least? If one is concerned with transfer pricing between high tax western countries such as Germany and low tax rate western countries such as Switzerland, adequate tools exist to allow the Treasury to allocate income and deductions properly to the two jurisdictions. Moreover, similar weapons exist in Germany and are likely to be applied. The authors argue that such transactions are difficult to scrutinize, which is true; but I would argue that this is a legitimate price to pay for respecting the sovereignty of Switzerland to determine its tax structure for income derived in its country.

Per Country Limitation on Foreign Tax Credit

A second tax recommendation, already commented on in part, is to repeal the overall limitation in favor of a per-country limitation for the foreign tax credit.[11] The virtue of the overall limitation, in the view of the authors, is that it is easier to administer than the per-country limitation insofar as the determination of a company's United States tax liability does not hinge on transfer prices for transactions between two foreign affiliates. However, the benefits of the per-country limitation could be had at a lower administrative cost, it is argued, if foreign source income could be put into high and low tax baskets. Then, only interbasket country transactions need be scrutinized for transfer pricing abuses. This would have the virtue of restricting the present ability of the United States multinational to shelter high tax rate income with excess foreign tax credits generated in low tax jurisdictions.

Four points should be noted about this proposal. First, it is somewhat inconsistent to suggest a reform in this context, as contrasted with deferral, which increases the necessity of monitoring transfer prices. Basket grouping is a weak palliative for this problem. Each basket will still have a range of statutory and effective tax rates which may establish transfer pricing incentives and will then have to be monitored. Moreover, different companies will be differently affected by the composition of the baskets. Second, there would be certain technical problems in administering a per-country limitation where income was transferred from various jurisdictions to a holding company or a tier of holding companies which subsequently remitted dividends to the United States. In order to enforce a per-country limitation, one would have to trace

11. The overall limitation is provided in I.R.C. § 904(a). United States policy has undergone numerous changes in its approach to the foreign tax credit limitation. We have moved from no limit in 1918 under the first foreign tax credit legislation, to an overall limitation in 1921, to the lesser of an overall or per-country limitation in 1932, to only a per-country limitation in 1954, to the current election system between per-country and overall in 1960. E. OWENS, THE FOREIGN TAX CREDIT 198–202 (1961).

back the source of funds through the holding company structure to the countries which generated the income. Otherwise, by channeling money to the holding company and using the holding company's tax rate as a basis for the tax credit, companies could arrange their affairs in such a way as to get the benefits of an overall limitation.[12] Third, the per-country limitation puts tremendous emphasis on the allocation of source of income to a particular country, apart from transfer pricing manipulation problems. At present, under an overall limitation, one must determine only whether the income involved is United States or foreign source. Finally, if loss recapture operates under the per-country limitation, as it presently does under the overall credit, the impact would be more severe, since single country losses are more likely than worldwide losses. Further, one of the main disadvantages of the per-country limitation was the failure to require losses in one country to be offset against income in others for purposes of calculating creditable foreign source income. This problem would remain, even if a loss recapture requirement was attached to the per-country limitation.[13]

If transfer price manipulation is of real concern, one might explore a statutory requirement that United States multinationals apply consistent and preapproved transfer price methodology to all intercompany transactions. This would go farther than leaving inconsistency justifications to audit responses. The consistency requirement might be waived upon a showing of particular need to vary the methodology due to local law. For example, prohibition by such countries as Brazil of related company royalty payments, a research and development recovery method, might justify a company's uplifted prices in only United States-Brazil export transactions, assuming the company normally recovered research and development expenditures through royalty payments.

Investment Tax Credit and ADR

The third recommendation is to extend the investment tax credit and ADR availability[14] to foreign income. The authors estimate that the extension of the investment credit would largely offset the impact of eliminating deferral on corporate income, United States taxes, and foreign taxes. The United States Treasury would have collected 1.5% more in corporate income taxes from manufacturing investors than it actually did in 1974, while corporate income after United States and

12. E. OWENS, *supra* note 11, at 233–34.

13. *See* Decelles & O'Connor, *The U.S. Foreign Tax Credit Limitation After the '76 Act*, 8 TAX ADVISOR 580 (1977).

14. I.R.C. § 48(a)(7) (investment tax credit); I.R.C. § 167(m), I.R.C. Reg. § 1.167(a)-11(b)(4)(6), Rev. Proc. 72-10, Com. Bull. 1972-1, at 721 (ADR).

foreign taxes would fall by less than 1%. The combined tax changes necessary to equalize the tax burden on foreign and domestic income would, thus, have a minimal impact on the balance between foreign and domestic investment.

One should pause here, however, and ask what is the purpose of the investment tax credit? If it is to provide incentives for direct investment domestically, then it should not be extended to foreign investment. Of course, this would violate the principle of neutrality but only from a capital export view. From the point of view of the host country, which does not extend the investment tax credit, United States extension would encourage investment in its country beyond the point that incentives exist for local investors, and this might be deemed undesirable.

DISC

The fourth principal recommendation is to repeal DISC.[15] This follows from the recommendation to repeal deferral, since DISC is seen by the authors as a means of countervailing whatever foreign investment incentives deferral creates. Of course, one could advocate repeal of DISC whatever the outcome of deferral. DISC is also, of course, a means to subsidize United States exports in a world in which many other countries provide similar incentives for products competing with ours, in the absence of an effective strategy to eliminate all such subsidies.

The authors, based on their model, found that the rate of return on DISC-assisted export sales was 17.3% in 1974, more than twice the comparable 8.4% return on domestic sales. Because export income is taxed at a lower rate than domestic income, there is some prima facie evidence that some portion of DISC tax savings were retained by United States exporters as profits after taxes, rather than passed on to foreign importers through lower export prices. The authors' best estimate (and it is only that) is that one half to three fourths of the tax savings made available by DISC were passed on through lower export prices and that the remaining one half to one quarter was retained by United States exporters. The authors then take into account the elasticity of foreign demand for United States manufactured exports, which implies that a 1% reduction in export prices expands the volume of United States exports by 2.85% and the value by 1.85%. Combining that elasticity with the estimate that DISCs reduced export prices by 2.5% in DISC-year 1974, and the fact that DISC-assisted exports amounted to $44 billion, they conclude that United States exports were $2.1 billion higher in 1974 than they would otherwise have been. This gain represents less than 3% of United States exports for that year. On the other hand, the 15% depreci-

15. I.R.C. §§ 991–996.

ation of the United States dollar against foreign currencies between 1971 and 1974 would have contributed more than ten times the DISC contribution to United States export growth. The authors conclude that DISC adds far less to net United States export production over time than is accounted for by currency changes and that DISC also overcompensates for the tax advantage of deferral in most instances.

The first point is not dispositive. Aside from generally promoting United States exports, DISC is meant to countervail the incentives for foreign investment from deferral. The authors assert that the DISC benefits overcompensated for deferral advantages in 1974 but do not supply the basis for such calculations. In any event, this line of analysis suggests reduction rather than elimination of DISC benefits. Although the match between DISC benefits and deferral benefits on a per-country basis might be difficult to achieve, a matching approach would argue persuasively for ending DISC for exports to countries with effective tax rates equivalent to those of the United States. Finally, it is interesting to note that the legal status of DISC as an illegal subsidy under the General Agreement on Tariffs and Trade (GATT) is basically left unchanged under the proposed amendments to article XVI of that treaty.[16]

MARKET STRUCTURE AND ANTITRUST

The authors are particularly concerned with the domestic market consequences of United States corporate investments abroad. They wish to determine whether multinational firms earn a higher domestic return than their domestic competitors by virtue of their foreign operations.

The authors advance various reasons, relating to economies of scale, why this might be the case. First, a substantial portion of United States foreign investment constitutes vertical integration of production and distribution across national boundaries. An example is petroleum

---

16. General Agreement on Tariffs and Trade, *done* Oct. 30, 1947, art. XVI, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 194. A panel report of GATT reached ambiguous conclusions on the question of whether DISC was an illegal subsidy under article XVI, paragraph 4. See GATT Doc. L/4422 (1976), *reprinted in* GATT, BASIC INSTRUMENTS AND SELECTED DOCUMENTS, 23d Supp. 127 (1977). The GATT Council has yet to take action on the report. *See* Jackson, *The Jurisprudence of International Trade: The DISC Case in GATT*, 72 AM. J. INT'L LAW 747, 777 (1978). The Tokyo Round has produced amendments to the GATT treaty, including new definitions of what constitutes a subsidy. GATT, Multilateral Trade Negotiations, Group, "Non-tariff Measures," Sub-Group, "Subsidies and Countervailing Duties." Interpretation and application of Articles VI, XVI, and XXIII of GATT, Annex, Illustrative List of Export Subsidies. Under the proposed treaty revisions a subsidy includes "deferral specifically related to exports." *Id.* at 37. However, note 2 to the definition states: "nothing in this text prejudges the disposition by the Contracting Parties of the specific issues raised in GATT document L/4422 [the Panel Report]."

exploration, extraction, transportation, refining, and marketing, each of which may be subject to substantial economies of scale. In each instance, a United States manufacturer integrated across national boundaries may enjoy substantial advantages over one who is not, and who can participate in foreign markets only through trading or licensing with independent firms. Second, a firm operating in two or more national markets may be able to spread joint overhead costs over a larger production and sales base than a domestic firm. Third, multinationals benefit from portfolio diversification. Portfolio theory tells us that new investment opportunities allow firms to raise their aggregate returns and/or reduce their aggregate risk, and foreign investment may encourage United States firms to make riskier but more rewarding domestic investments than they otherwise would. Fourth, there are tax considerations. Although the tax incentives to allocate global income to foreign affiliates rather than to the United States parent are generally small, as seen above, there may be significant exceptions.

It is acknowledged that each of these advantages has its domestic counterpart. Vertical integration is common within the United States, and cost spreading and portfolio diversification are common across regional markets or separate product lines. Since some states have corporate income taxes, national firms may be able to avoid some taxes that regional firms cannot. However, it is contended that the size of the benefits may be particularly large in a foreign context. Of course, if all these advantages accrue to foreign investment, one must ask why all domestic firms do not invest abroad. The authors believe that the answer lies with barriers to entry, stating

> [a]t the outset, foreign investing can be quite risky. Although established multinationals are often the picture of financial health, they may have written off substantial entry costs and investment losses against past income. . . . The barriers to foreign investing — the size of the required investments, the uncertainty about the eventual return, the lag between selling and harvesting — are thus comparable to the barriers to domestic competition — advertising, R&D and so on.[17]

The proposition the authors are interested in investigating requires demonstrating a cause and effect relationship. Two possibilities exist. It may be that firms with domestic market power, defined as firms which reach a large scale in concentrated industries, invest abroad, and, thus, domestic market power may lead to foreign investment. On the other hand, foreign investment itself may contribute to domestic

17. AMERICAN MULTINATIONALS, *supra* note 2, at 236.

market power, that is, increase firm market share and thus concentration in a particular industry. It appears that these propositions are not necessarily mutually exclusive, further clouding the possibility of causal analysis.

The authors attempt to investigate this cause and effect relationship by using Internal Revenue Service income statistics to determine how much United States corporations of different sizes and in different industries earned from domestic investments between 1965 and 1971. Comparable statistics were gathered on firms' advertising expenditures, employment of scientific personnel (technology level), average size, and other attributes. Multiple regression analysis was used to measure the contributions of these firm attributes to both domestic profitability and to the firms' foreign investment positions and to see whether by holding other factors constant, higher domestic profits are associated with more foreign investment. The authors state "while even the complex regression analysis cannot tell which is cause and which effect, it is hard to believe that the increasingly strong statistical relation between foreign investing and domestic profitability that emerges could be caused by the pressure of domestic liquidity on foreign investment alone." [18] They found that "multinational firms are twice blessed. In addition to the foreign dividends and tax credits received, the positive and statistically significant coefficient of foreign investment [measured against domestic profitability] indicates that foreign investing raised domestic profits net of foreign dividends and tax credits." [19]

The regression analysis, the authors claim, clearly justifies giving preference to the foreign investment explanation rather than to the firm size explanation. Their equations show for all industries that a significant proportion of domestic profitability, the dependent variable, is greatly explained by foreign investment, one of the independent variables. It is not explained, in contrast, by another independent variable — firm asset size. Separate data is not presented for particular industries, but the authors assert that an examination of the underlying data shows that "[*m*]*ultinationals tend to be more profitable, even ignoring their foreign dividends and tax credits, than domestic firms in the same industry*." [20] Of course, the intraindustry effects are critical, since the concern is with market power within industries. The lack of presentation of this data is a glaring omission. This analysis does not eliminate

18. *Id.* at 239.

19. *Id.* at 245.

20. *Id.* (emphasis added). Domestic profitability is defined as domestic net return deflated by parents' assets, and foreign investment is defined as foreign dividends plus tax credits deflated by total firm assets. Foreign investment has a coefficient of .28 with a *t* statistic of 8.6. This compares with an asset size coefficient of –.009, with a *t* statistic of –5.5.

the possible explanatory power of other independent variables not measured or used, such as economies of scale, which the authors' own theory suggests is the key consideration. The variable of firm asset size does not adequately capture economies of scale; we would have to measure firms' foreign investment against optimum asset size. Finally, one must ask whether the asserted increased domestic market concentration is undesirable. To the extent it reflects scale economies attributable to multinational production, it should increase consumer welfare. Let us turn now to the specific policy recommendations.

Split-Off of Foreign Operations

One recommendation the authors make is for antitrust law to encourage breaking up multinational firms so that their foreign subsidiaries might compete with United States parents, thus promoting more competition in the United States. This is part of a general prescription that antitrust authorities should be looking more to foreign sources for effective competition in the United States. The authors single out IBM as an example, with the following observation:

> Consider the following scenario. After years of litigation and appeal, the Justice Department succeeds in showing that IBM monopolizes the U.S. market for digital computers. The time has come for deciding what to do about IBM's monopoly position. A major obstacle to splitting up IBM into smaller pieces may be that IBM is a highly integrated company; it has no natural cleavages. . . . But what about IBM Europe? Under European pressure, and perhaps with economic logic, IBM Europe has become a highly integrated company. It has its own manufacturing plants for all but the largest computers, its own research programs, its own management, and so on. Were the ownership ties between parent and subsidiary severed and no contractual obligations . . . put in their stead, IBM Europe would be a creditable new entrant to the U.S. market. In short, without having to build new factories, train new managers, create new legal entities, and so on, a new and creditable entrant into the U.S. market would be born. IBM Europe might not be able to compete immediately with its erstwhile parent at the very frontiers of computer technology, but the infusion of a relatively small number of added personnel (attracted perhaps from European computer firms without such a strong foundation or perhaps from the parent IBM) could well enable it to do so in a relatively short period of time.[21]

This specific recommendation seems to have little to do with the inves-

21. *Id.* at 267.

tigation of the statistical pattern between foreign investment and United States market power. The split-up is premised on a finding of domestic monopoly rather than the fact that IBM parent's investment in IBM Europe has increased its domestic market power.

A further problem is raised insofar as the authors assume that IBM Europe is not already a participant in the domestic market. This seems to imply that United States buyers are unable to purchase IBM computers made in IBM Europe subsidiaries, which is not so. IBM foreign subsidiaries, such as IBM Germany, are not prohibited from selling directly to United States customers, to customers abroad who might move the computers to the United States, or to leasing companies which might market in the United States. Indeed, one would expect that if significant price differentials developed between computers made in the United States and in Germany, such activity would occur. Given recent movement of exchange rates, one might expect, however, that it might be German customers coming to the parent, rather than the reverse, so that this remedy, in the short run, would only serve to deconcentrate the German, rather than the United States, market.

This is not to imply that a single firm is always likely to promote active price competition between its domestic and foreign subsidiaries. While a monopoly does have an interest in internal sourcing based on cheapest cost, external factors, such as political risk, exposure to currency changes, or the necessity for obtaining remittance approvals, may argue for maintaining diversification despite lower production costs and higher marginal returns available from single source production. Price competition between the subsidiaries based on pure production cost considerations would tend to eliminate these multiple sourcing advantages and may thus be restrained by the firm. Arguably, however, long-term consumer interests are served by multiple sourcing even with the attendant competition limitations. If government *X* adopts a policy which trebles the cost of producing in *X*, the company, and thus the consumer, can turn to *Y* source. Additionally, the availability of *Y* source may restrain government *X*, at least in the absence of an intergovernmental cartel. These considerations argue that there may be important costs to a foreign split-up.

An appraisal of economies of scale should also inform the foreign split-up choice. One might speculate that the presence of two IBMs, one domestic and one foreign, competing actively in the domestic large digital computer market might lead to more, rather than less, concentration in the United States marketplace. It is possible that IBM now fears attaining an ever increasing market share in the United States because of domestic antitrust reasons and, accordingly, attempts to limit market share in a way that two IBMs would not. Each of the

IBMs might not only compete away some of the other's business, but also capture business now held by other domestic competitors. If the current size of IBM, or any other alleged monopolist, results from economies of scale, one might hypothesize that competition between two IBMs would result in a victory for only one of them. Such predictions depend on one's appraisal of scale economies firms can achieve in this industry. Of course, one can argue that present IBM restraint, to the extent it exists, is undesirable and that the split-up would be desirable insofar as it allowed "taking the gloves off."

It may be argued that courts have, and should have, the broad equitable power to split-up foreign and domestic operations, once it is shown that they are dealing with a monopolist which has engaged in *significant* exclusionary conduct.[22] While we need not be overly concerned by the weight of precedent in this area — the case law is quite thin — as a prescriptive matter, there is great merit in tying any split-up remedy to significant exclusionary conduct; otherwise, one might deprive the society of the benefits of scale economies which could be minimally related to such conduct. It may be that a higher burden of significance should be required for the split-up remedy than for the proof of monopoly itself. Once having found significant exclusionary conduct, the assumption that exclusionary conduct, rather than scale economies, has led to market concentration is then more plausible. One should then be more concerned with depriving the monopoly of the fruits of such practices by tailoring a remedy to promote competition in the relevant geographical and product market. Split-up alternatives should then be appraised in terms of their ability to deconcentrate the relevant domestic product market.

If one were concerned with a United States market in large-scale digital computers, for example, one would search for the split-up most tailored to promote competition in that market. The foreign split-up may not qualify, since it leaves the single firm intact in the alleged concentrated geographic market and is not product specific, *i.e.*, both the IBM parent and IBM Europe may each manufacture a wide range of products other than large scale computers. Further, cost disparities and trade barriers may prevent IBM Europe from being an effective competitor in the United States marketplace. Of course, there is convenience in splitting at a pre-existing cleavage to minimize dislocation and to assure that the units resulting are self-sufficient. But deference to existing cleavages allows the company to predetermine the split-up by devising a particular corporate structure. The point is not to reject the foreign

---

22. P. Areeda & D. Turner, 3 Antitrust Law ¶ 627c(3) (1978).

split-up entirely, but to measure its benefits against its costs, along with other feasible alternatives.

One must also look at foreign split-ups from the point of view of the other countries affected. An IBM Europe split-up, for example, might create IBM Europe as a more dangerous and effective competitor of the European champions — the firms that are actively subsidized by European authorities, such as Siemens (West Germany), Honeywell-Bull (France), Olivetti (Italy), or International Computers Limited (United Kingdom) — a competition that such foreign governments might well oppose. Neither IBM Europe nor IBM United States may be as efficient a producer of computers standing alone, and, therefore, each may be less able to serve the needs of the marketplace. This might result from duplication of research and development and other common costs, such as standard tooling, necessitated by the split-up. While separate research may now be done in Europe, research is centrally funded by the parent corporation and may not be able to stand alone technically or financially.

Finally, one must stress the real dangers to consumer welfare of making the wrong split-up determination and question whether the government or the courts are well equipped to make intelligent judgments on such matters. It is one thing to split-off from a company a previously acquired firm or a separate line of business; it is much more difficult to split-up a particular product line, *e.g.*, large scale computers, in a firm which has grown by internal expansion. In such a case, perhaps the better course, notwithstanding a finding of significant exclusionary conduct in the past, would be to regulate the firm like a public utility.

Bathtub Conspiracies

The authors also criticize "a legalistic emphasis on the intent of the defendant, rather than on the economic cost or benefit"[23] of anti-competitive behavior. They note that a conspiracy between a domestic corporation and its overseas rivals to fix prices and divide markets is illegal per se, but that a comparable conspiracy between a parent and its overseas affiliates is not. Although a parent and a subsidiary are separate legal entities and, thus, capable of conspiring, agreements among related companies (dubbed Bathtub Conspiracies) are perfectly legal.[24] The authors go on to argue that "if the ultimate objective of antitrust policy is to promote competition and/or economic efficiency, rather than to punish criminal wrongdoing . . . monopolists should be judged not by the intent but by the consequences of their behavior."[25]

23. AMERICAN MULTINATIONALS, *supra* note 2, at 266.
24. *Id.*
25. *Id.*

Contrary to their assertion that intracorporate activity is not subject to antitrust attack, four cases in the Supreme Court indicate that a violation of the Sherman Act may be based on conduct involving member firms of the same group, at least where commonly owned firms "hold themselves out as distinct entities."[26] While the Court has not found such an anticompetitive conspiracy on the merits, the impermissibility of such conspiracies exists, and may result in liability from which a single firm would otherwise be sheltered, *i.e.*, price-fixing between two subsidiaries or a parent and a subsidiary. Beyond the four Supreme Court cases, district and circuit courts have increasingly upheld allegations of intracorporate conspiracy in a wide variety of situations such as price fixing, boycotts or refusals to deal, tie-ins, or divisions of the market.[27]

It is still unclear, however, what amount of competition between alleged conspirators is necessary to sustain an allegation: there is disagreement in the circuits as to whether an alleged conspiracy can stand absent competition between the conspirators.[28] All circuits agree, however, that if there is competition, apparently notwithstanding whether the related companies actually hold themselves out as competitors (as compared to distinct entities), then the intracorporate conspiracy allegation will state a cause of action. In the circuits which do not require competition as a predicate for alleging the conspiracy, it is likely that a section 1 violation will fail on the merits anyway due to lack of competition, since the Sherman Act requires proof of a restraint on competition.

While certain commentators have been quite critical of the development of the intracorporate conspiracy doctrine as putting form over substance,[29] since a parent cannot conspire under the Sherman Act with a nonincorporated division, nor can officers or directors conspire

---

26. United States v. Citizens & S. Nat'l Bank, 422 U.S. 86 (1975); Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968); Kiefer Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951); United States v. Yellow Cab Co., 332 U.S. 218 (1947).

27. For price fixing, see Coleman Motor Co. v. Chrysler Corp., 525 F.2d 1338 (3d Cir. 1975); Minnesota Bearing Co. v. White Motor Corp., 470 F.2d 1323 (8th Cir. 1973); for boycotts or refusals to deal, see Cromar Co. v. Nuclear Material & Equip. Corp., 543 F.2d 501 (3d Cir. 1976); Diehl & Sons, Inc. v. International Harvester, 426 F. Supp. 110 (E.D.N.Y. 1976); for tie-in, see Battle v. Liberty Nat'l Life Ins. Co., 493 F.2d 39 (5th Cir. 1974); and for territorial market division, see Knutson v. Daily Rev., Inc., 548 F.2d 795 (9th Cir. 1976).

28. *Compare* Battle v. Liberty Nat'l Life Ins. Co., 493 F.2d 39 (5th Cir. 1974) *with* TV Signal Co. v. American Tel. & Tel., 462 F.2d 1256 (8th Cir. 1972) (competition not necessary) *and* Knutson v. Daily Rev., Inc., 548 F.2d 795 (9th Cir. 1976) (competition a factor).

29. *E.g.*, Willis & Pitofsky, *Antitrust Consequences of Using Corporate Subsidiaries*, 43 N.Y.U. L. Rev. 20 (1968).

with the company, the trend in this area appears expansionary, and no fundamental change is needed in antitrust law for challenges to be brought in such situations. Given this state of affairs, intent or other justification is irrelevant for proving many intrafirm conspiracies, such as price fixing; they are per se illegal within and without the firm. The concern of the authors is, therefore, somewhat unfounded. Of course, in the absence of the availability of such allegations, proof of monopoly by a single firm (as opposed to a conspiracy among firms) would require some showing of exclusionary conduct but not intent as the authors apparently imply.[30] A more interesting and difficult question is whether a monopoly allegation should stand without proof of conduct.[31]

CONTROLS AND ADJUSTMENT ASSISTANCE FOR FOREIGN INVESTMENT

The fourth major policy recommendation of the authors is to establish an "escape clause" for foreign direct investment. The authors state:

> Our analysis throughout this volume concludes that on balance, foreign direct investment by American multinationals is not adverse to most aggregate U.S. economic interests. However, it indicates that there are numerous criteria, including employment and the balance of payments, in which specific foreign direct investments may be adverse to particular U.S. interests. Within the general policy of continued freedom for foreign direct investment, a mechanism to assess the impact of specific investments on such variables and to provide policy responses in selected cases is needed. No such mechanism exists today.[32]

Under the Trade Reform Act of 1974, individual United States firms or workers can petition for relief from increased imports by submitting a case to the United States International Trade Commission (ITC), formerly the Tariff Commission.[33] The ITC hears the views of interested parties — importers, consumers, and the United States representatives of the foreign exporters — and reports to the President whether "an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat

30. "[I]n defining the behavioral component of the monopolization offense, one must concentrate on conduct and define the characteristics of conduct that are undesirable. Despite loose language, this is in fact what courts have attempted to do. They have focused on conduct while talking about intent." P. AREEDA & D. TURNER, *supra* note 22, ¶ 626a.

31. *Id.* ¶¶ 619–25.

32. AMERICAN MULTINATIONALS, *supra* note 2, at 467.

33. Trade Act of 1974, 19 U.S.C. § 2251(b)(1) (1976).

thereof, to the domestic industry producing an article like or directly competitive with the imported article." [34]

When the ITC finds that imports have, in fact, caused injury, it forwards its analysis and recommendation to the President. The President then decides upon the basis of a number of factors, whether to do any or all of the following: (1) impose or increase duties on the article; (2) proclaim a tariff-rate quota on such article; (3) modify or impose a quantitative restriction; (4) negotiate an orderly marketing arrangement.[35] In addition, separate procedures are established under the 1974 Trade Reform Act not dependent on the proceedings or standards for ITC action, for firms, workers, or communities to receive adjustment assistance based on injury from imports.[36] Such assistance is furnished through proceedings in the Department of Labor (workers) and Department of Commerce (firms and communities). If the Department of Commerce determines that imports have "contributed importantly" — a lower standard than the "substantial cause" test in ITC proceedings — to unemployment or lower sales of firms, or if the Department of Labor makes a similar finding, firms and workers respectively can receive assistance. The community assistance determination in the Department of Commerce applies the "contributed importantly" test to unemployment or production loss in a community.[37] The combination of a lower standard of proof together with removal of adjustment assistance from a more neutral ITC to clientele agencies has considerably reduced the burden of obtaining adjustment assistance.

The authors would apply the same kind of procedures as used under the old Trade Expansion Act to require disinvestments, block proposed new foreign investments, or give adjustment assistance.[38] The ITC

---

34. *Id.*

35. 19 U.S.C. § 2253 (1976). The authors leave one with the mistaken impression that presently the ITC or President are directly involved in the adjustment assistance determination, which was the case under the Trade Expansion Act, but is not under the Trade Reform Act. AMERICAN MULTINATIONALS, *supra* note 2, at 467–568.

36. 19 U.S.C. §§ 2271–2322 (worker assistance), §§ 2341–2354 (firm assistance), §§ 2371–2374 (community assistance) (1976).

37. "Contributed importantly" is defined, in reference to all three types of assistance, as "a cause which is important but not necessarily more important than any other cause." 19 U.S.C. §§ 2272(3), 2341(c)(3), 2371(c)(3) (1976).

38. The authors point out the trigger for community assistance under the Trade Reform Act need not only be injury caused by imports, but also may be injury produced by "the transfer of firms or subdivisions of firms located in such area to foreign countries . . . ." 19 U.S.C. § 2371(c)(3) (1976). This is an important development in furnishing adjustment assistance as a result of a particular kind of foreign investment, the actual *transfer* of a firm — the "runaway plant"; it would be a far different matter to give such assistance where a community was injured because of the opening of a new plant abroad; indeed, which *particular* community or group of workers would be entitled to relief in such case?

It is interesting, however, that only a few communities have sought assistance under

would make an injury finding based on economic factors like those in the trade law, *i.e.*, effect on domestic employment, and assess several other factors peculiar to foreign investment, such as the effect of a proposed investment on the United States balance of payments and the long run competitiveness of the United States economy. Standing would be given to groups of workers who believe their jobs are being exported, to communities hurt as the result of transfers of production, and to other firms in the industry that feel they may be compelled to invest abroad to remain competitive but, if given assistance, may remain competitive without investing abroad. ITC findings would be submitted to the President including recommendations for action when the facts substantiate an injury claim.

Several types of policy remedies would be available to the President:[39] (1) If the foreign direct investment promotes the national interest but adversely affects the interests of specific groups, the investment would proceed and the government could finance adjustment assistance for those groups. Such cases would include investments that "enable firms to gain access to new technology, to penetrate markets otherwise unavailable due to trade or other barriers, or to remain competitive (and thus perhaps maintain markets for some U.S. exports) in light of the investment decisions of foreign firms."[40] (2) If the foreign direct investment appears to have little net impact on the national interest but an adverse impact on the interests of specific groups, *e.g.*, workers, it should be permitted if the firm itself would finance adjustment assistance. (3) If the foreign direct investment appears to unduly speed the pace of change for United States industry to remain globally competitive, it could be delayed or reduced in magnitude. The case of a United States electronics firm investing in Taiwan in anticipation of Japanese penetration of the United States market five years later is given as such an example. (4) If the foreign direct investment appears extremely injurious to the national interest, it could be permanently blocked or disinvestment could be required.

What is the motivation for such a suggestion? In part, it appears to be a response to concerns of the AFL-CIO, which is now challenging certain foreign investments on the grounds of United States job dis-

---

the runaway plant provision and none successfully. The reasons appear to be: (1) the difficulty of showing loss of unemployment in the *community* as a whole, *i.e.*, the employment loss due to plant transfer may be offset by growth in other industries; (2) relating the loss, if it exists, to plant transfer; and (3) the availability of other community assistance programs, under the Public Works and Economic Development Act of 1965, *as amended*, 42 U.S.C. 3121–3246h (1976), without the need to demonstrate cause. Telephone interview with Jack Osborne, Director, Office of Trade Adjustment Assistance, Department of Commerce (April 1979).

39. AMERICAN MULTINATIONALS, *supra* note 2, at 470–71.

40. *Id.*

placement. Interestingly, the authors' own empirical investigation of the relationship between export displacement and foreign investment suggests the relation between foreign investment and exports or imports is largely haphazard. In industries or countries with minimal United States investment, an expansion of United States investment is likely to be matched by an expansion of United States exports. This complementariness results from foreign subsidiaries focusing their initial activity on the marketing and assembly of the domestic parent's product line. There is also some evidence that certain industries marked by high foreign investment, such as communications equipment, have experienced faster-than-average trade growth. But without more detailed industry studies, the authors state that it is impossible to determine the extent to which foreign investment was the cause, the effect, or merely a spurious correlate of the growth of imports.

Their own difficulty in conducting empirical analysis should caution against believing that the injury determination which the authors propose, dependent as it is on causal analysis, will be workable.[41] It will also be difficult or impossible to make informed judgments about the presence or absence of the factors deemed important in presidential policy choices. For example, the President's course of action depends on whether the particular investment promotes "the national interest." The authors seem to assume that the national interest is co-extensive with investments that enable firms to gain access to new technology, to penetrate markets otherwise unavailable due to trade or other barriers, or to remain competitive in light of the investment decisions of foreign firms. Needless to say, this is not a complete list and such national interest determination will be extremely difficult. Such uncertainty will severely stifle investment planning and decisions of firms affected. At least in the import program, where one is assessing injury

41. The amount of assistance actually disbursed to firms or workers under the 1962 Trade Expansion Act adjustment assistance program was not substantial. As for firms, under the Trade Expansion Act (1962–1975) total adjustment assistance to firms was $45.3 million — $39.5 million in financial assistance, $1.9 million in technical assistance, and $3.9 million in tax benefits (special loss carry back provisions). TWENTIETH ANNUAL REPORT OF THE PRESIDENT OF THE UNITED STATES ON THE TRADE AGREEMENTS PROGRAM 49 (1978). Under the Trade Reform Act of 1974, as of March 31, 1979, total adjustment assistance was $129 million — $11.9 million in technical assistance and $127.3 million in financial assistance. DEP'T OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, TRADE ADJUSTMENT ASSISTANCE FOR FIRMS *passim* (1979). As for workers, under the Trade Expansion Act total income assistance was less than $69 million over the entire period. SENATE COMM. ON FINANCE, TRADE REFORM ACT OF 1974, S. REP. NO. 1298, 93d Cong., 2d Sess. 131 (1974). Under the 1974 Trade Reform Act, $577 million has already been given in income assistance to 386,000 workers. In addition, 12,000 workers have been placed in other jobs; 12,000 have received allowances for job searches; and 1000 workers have been given relocation assistance. Telephone interview with Harold Bratt, Deputy Director, Office of Trade Adjustment Assistance, Department of Labor Official Records (April 1979).

or threat of injury of a given imported product at a known price on the position of *United States* firms and their employees, there is some empirical basis for making an assessment.[42] Comparable product information will be much harder to obtain at the foreign investment stage, and initial product choice and markets for those products may change over time.

If one applies this policy *ex post facto* to require disinvestment of United States firms, other problems will arise. There will be a dead weight loss to the system from the disinvestment itself. More importantly, the international effect of a plant closed down in a foreign country, based on the ITC's and President's decision that such plant's existence was not in the national interest of the United States, would create a much more damaging confrontation than the one the authors seek to avoid in the natural resources area. Of course, the United States already has policies in place, such as those applicable to trade with communist or Arab countries, which could affect the level of investment abroad as well as in the United States, but those policies are quite limited in their scope in terms of their effect on total foreign investment of United States firms. Moreover, those policies would not discriminate in favor of United States exports at the expense of foreign investment. Although the authors seek to minimize potential confrontation through anticipating exemptions from such controls of investment in certain "fourth" world countries — which have not been defined — or requiring compensation to foreign governments through an international agreement where the United States has "unjustifiably restricted" the capital outflow, the possibility of getting international agreement to allow the United States to engage in this action at all is remote, and retaliation can be anticipated. Indeed, there was much objection to our milder foreign direct investment restraints in the 1960's.

There are two further substantial problems. First, it is not clear which firms would be subject to foreign investment control. Presumably these actions would apply to "United States" firms, but how are we to identify what a United States firm is? If the actions apply to all firms investing outside the United States, once having invested in the United States, international repercussions would ensue between the United States and governments which are the home country for multinationals with investments in this country. Second, it is unclear which foreign investment decisions would be subject to review. Although the authors characterize the foreign investment decision as involving the establishment of plants abroad, the more common form of foreign investment

42. Causality is still, however, a substantial problem. *See* J. JACKSON, LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 684–88 (1977).

is incremental. Decisions are made by multinationals to source a particular product in an existing plant in one country rather than another. This may or may not require the physical expansion of a given plant. If all incremental sourcing decisions are to be defined as within the ambit of foreign investment (including the decision to reinvest subsidiary earnings), firms will be unable to make decisions in a reasonable time frame. If only new plant decisions are covered by such controls, we will find that corporations will adapt by expanding incrementally and perhaps inefficiently on existing plant structure. One must also consider whether debt and equity plant expansion would be equally subject to review.

Domestic firms have had enough problems with the limited United States export controls governing trade flows from the United States to communist countries today; they would be a drop in the bucket compared to the consequences of adopting the proposals put forward in this book. If the authors want a planned economy for foreign investment, we should not put the cart before the horse — let's face squarely government planning on the domestic side. Many forms of domestic investment arguably are not in the best "interests" of the United States, under some particular view of those interests. The essence of a capitalist system is to leave most investment decisions in the domestic context to the private sector on the theory that the market will be a more effective, if not perfect, allocator of resources than the government. The same reasoning applies in the foreign context. Of course, the United States does exercise control over investment in many sectors of the United States economy, directly through proscription or indirectly through regulation. But such controls are justified by specific reference to a peculiar problem, such as safety, and there are still many sectors of the economy, such as computer manufacturing, which are relatively unregulated or uncontrolled. This proposal, on the other hand, would subject *all* foreign investments to review on the basis of a vague national interest standard.

Finally, as for the concern with workers which is, after all, the underlying political motivation, why should particular relief be tied to such narrow causes as imports or foreign investment? Various decisions by firms and government lead to job displacement or income loss for various people in our economy, *e.g.*, closing down a nuclear reactor or contracting the money supply. Inflation probably damages groups in society far more than the decisions of any particular firm. The way to handle such matters is to have *general* social welfare policies which guarantee individuals a certain amount of income no matter what the reason for the need. It is only the political power of the AFL-CIO which argues for a program to guarantee displaced workers' income

at levels beyond those which our social welfare policies seek to secure for individuals generally.

GENERAL APPROACH

It remains to comment on the general approach of this book, reflected in the title. The focus is on *United States* multinationals. One distinct aspect of multinationals is that they have many political bodies to which they can be or are responsible. Even if we knew what an "American" multinational was, it is clear that its foreign subsidiaries located in various countries in the world are, in some sense, endowed with a nationality or responsibility towards host countries. This suggests that policy toward multinationals is a matter for multinational and not national determination. Almost all the authors' recommendations put United States policy into potential conflict with the policy of other governments. Ending deferral may undermine tax incentives provided by others. Adjustment assistance determinations could prevent a company from investing abroad or result in closing a foreign plant. Although the authors do, at various points, look at the need for international action, this is at best a secondary consideration. It should be primary. The very concept of a *United States* multinational is a doubtful one.

The second conceptual problem is the vagueness with which the term "American interests" is defined. What are such interests? Often we are told it is neutrality between foreign and domestic investment, yet the authors are willing to breach neutrality for a particular end — they suggest that deferral not be ended or adjustment assistance review conducted for investments in "fourth" world countries. Why are such exceptions being made? If the objective is one of world income redistribution, then the focus of analysis should be on how United States policy can accomplish this generally, rather than have United States policy toward multinationals wag this dog. The neutrality principle itself seems to this reader to be a rather empty one; there are many kinds of different neutrality possible in the world. As demonstrated in the discussion of deferral, while the United States remains "neutral" between its treatment of foreign investment income and domestic investment income, this neutrality is premised on the assumption that it is correct for the United States to tax income the same way no matter where it is generated.

Finally, too little attention is given to what the United States could do to help multinationals in their attempt to promote efficient allocation of resources. It is in the interest of many of the more advanced multinationals to operate in different host countries of the world in a

standard fashion. This reduces the costs of management and avoids conflicts with governments which might otherwise accuse firms of acting in inconsistent ways to their own advantage. For example, if transfer pricing is conducted differently in transactions between different countries, the firm is open to the accusation of manipulation and unfair treatment, whereas if the corporation adopts a standard way of transfer pricing, such accusations are less probable. Or if a firm tries to recover royalties through a standard licensing agreement, with a common base and rate applicable to all foreign subsidiaries to which it transfers technology, countries will be less likely to accuse it of acting to take advantage of a particular situation, *i.e.*, dependence on the technology.[43] Unfortunately, as the legal systems of various host countries change (such as by preventing intracorporate royalty payments between related companies), it becomes increasingly impossible for the multinationals to operate in a standard way. This means exceptions from standard policies in countries where such policies would be illegal. This, in turn, will result in increased suspicion by host governments that different methods of operation imply manipulation to the advantage of the multinationals, rather than adjustments to legal necessities.

The United States should seek to promote standard rules of the game, or "international law," to re-establish a climate in which multinationals can operate in a standard fashion. The uniformity of rules may be even more important than the content of such rules. Although this may be somewhat utopian, as reflected in the difficulty in promulgating the UNCTAD Code on Technology Transfer, the United States should strongly support such efforts in order to establish a more uniform rule of law in the world. It should follow up and extend its efforts on the OECD guidelines for multinationals.

Past commentators have given undue emphasis, in my judgment, to the difficulties of a multinational corporation in being subject to different policies of the host and home country, and they have attempted to generalize from the particular and unusual circumstances in the antitrust or export control area to the conclusion that the major problem for multinationals arises through the assertion of cross-national jurisdiction by home countries. A much more severe problem is the effect

---

43. Compare the following laws regulating technology transfer in Latin America: Normative Act No. 15 of Sept. 11, 1975, *reprinted in* [1979] I INDUS. PROP. LAWS & TREATIES (WIPO) (Brazil) 6-001 *and in* [1979] 2B J. SINNOTT, WORLD PAT. L. & PRAC. (MATTHEW BENDER) (Brazil) 32; Law No. 21.617 of Aug. 12, 1977, Official Gazette, Aug. 12, 1977, *reprinted in* [1979] I INDUS. PROP. LAWS & TREATIES (WIPO) (Argentina) 6-001 *and in* 2B J. SINNOTT, WORLD PAT. L. & PRAC. (MATTHEW BENDER) (Argentina) 12; Law for the Registration of Transfer of Technology and the Use and Exploitation of Patents and Trademarks, Official Gazette, Dec. 30, 1972, *reprinted in* [1979] II OFFNER'S INT'L TRADEMARK SERV. (Fieldston) (Mexico) 36.

of the proliferation of host country legal systems on the internal operation of the multinational corporation. Multinational corporations can adapt to two sets of authorities because in most instances the controls exercised are cumulative and do not present a true conflict situation. However, it is extremely difficult to adopt internal systems and rules which apply equally well in very different political and legal environments. Without uniform rules, each decision made by the multinational requires different operating procedures and decision methodology, vastly adding to the cost of running a worldwide operation. We take this need for uniformity for granted in this country by enacting uniform state or federal law in important areas of commerce.

Despite the critical tone of this review, this book must be read by anyone seriously interested in the policy debates of the day. Bergsten is now Assistant Secretary of the Treasury for International Monetary Affairs; Horst is Assistant Director for International Taxation in the Treasury Department; and Moran is on the State Department's policy Planning Staff. The book, although making recommendations with which I disagree, does provide one of the most useful available focuses for considering the contours of United States policy in this area.

CHINA, THE UNITED NATIONS AND WORLD ORDER. By Samuel S. Kim.[1] Princeton: Princeton University Press, 1979. Pp. xviii, 581. $32.50 cloth; $12.50 paper.

The entry of the People's Republic of China (PRC) into the United Nations in 1971 ended the twenty-year-old guessing game over what would happen if the PRC joined such major multilateral organizations.[2] Abundant speculation, mostly directed at potentially disruptive Chinese behavior, was confronted, at last, by the reality of the PRC's presence in the United Nations and its constituent institutions. Professor Kim presents a much-needed comprehensive survey of that reality, and demonstrates that Chinese participation, though flawed, has had its benefits. In addition, he sketches out a Chinese conception of world order based on notions of justice, struggle, self-reliance, and sovereignty, as seen through the PRC's multilateral diplomacy.

Professor Kim's conclusion that no disruption has occurred as a result of the General Assembly's decision to recognize the PRC as the sole legitimate representative of China[3] makes absorbing reading, particularly in light of the negative assertions of earlier Cassandras. During the PRC's long absence, many commentators looked to the Chinese to take an obstructionist posture upon entry, and often pointed to the PRC's supposed disrespect for international law and institutions.[4] Kim asserts that while the Chinese have, on the contrary, made studied efforts to maintain a low profile, the very fact of Chinese participation offers the institutions the universality they have lacked since their inception. Kim offers a composite image of the PRC in a mainly reactive stance, with a selective interest in problems and issues (disarmament, development, and decolonization dominate), undertaken by men

1. Professor of Political Science, Monmouth College; Visiting Fellow, Center of International Studies, Princeton University, 1976–1978.

2. When the United Nations was founded in 1945, the Republic of China (ROC) was one of its five founding members. Shortly after the establishment of the People's Republic of China (PRC) on October 1, 1949, the PRC expressed its desire to send representatives to the United Nations as the only legitimate representatives of the Chinese state. However, those early attempts failed, and the PRC remained outside the United Nations. Feeney, *The Participation of the PRC in the United Nations*, in SINO-AMERICAN DETENTE AND ITS POLICY IMPLICATIONS 104, 105–06 (G. Hsiao ed. 1974). It was not until October 25, 1971, that the Albanian resolution to seat the PRC and expel the ROC was passed by the requisite majority. 26 U.N. GAOR (1976th plen. mtg.) 41, U.N. Doc. A/p.v. 1976 (1971). For the text of the resolution, see G.A. Res. 2758, 26 U.N. GAOR, Supp. (No. 29) 2, U.N. Doc. A/8429 (1972). For a discussion of the procedural background, see Lichtenstein, *The People's Republic of China and Revision of the United Nations Charter*, 18 HARV. INT'L L.J. 629, 631 n.10 (1977).

3. G.A. Res. 2758, 26 U.N. GAOR, Supp. (No. 29) 2, U.N. Doc. A/8429 (1972).

4. S. KIM, CHINA, THE UNITED NATIONS, AND WORLD ORDER 105 (1979). *See, e.g.*, McDougal & Goodman, *Chinese Participation in the United Nations: The Legal Imperatives of a Negotiated Solution*, 60 AM. J. INT'L L. 671, 703–18 (1966).

and women of principle, who are well liked by international civil servants. He views them as taking care to shy away from a leadership role, even among the PRC's natural constituency, the third world.[5]

This image is developed in the pages of a generally perceptive and highly organized work. Kim begins with a synopsis of the traditional Chinese idea of world order, followed by a similar exposition on the Maoist idea of world order. After examining the details of the PRC's multilateral behavior between 1971 and 1976, he then reviews his conclusions in light of the World Order Models Project (WOMP), whose precepts he has chosen to guide his study. Several important areas receive particular attention. In addition to excellent chapters on the General Assembly, the Security Council, and the Specialized Agencies, he has included two chapters on the New International Economic Order (NIEO) and one on the international legal order.[6] While the chapters on NIEO are testimony to the PRC's developmental priorities and symbolic activism, the chapter on the legal order is an equally persuasive brief for the PRC's substantive passivism. Indeed, Kim notes that few legal issues have merited much time and space in the record of Chinese participation, and he discusses the PRC's actions on only a handful of law-related topics: the effect of General Assembly resolutions, the Charter review question, the Law of the Sea, and the definition of aggression.

Kim's book should be recommended for the evidence that he has marshalled at least as much as for its unexpected conclusions. Until now, one who sought to study the PRC's behavior in the United Nations and other international organizations was hard pressed to move beyond the publicly available rhetoric of the PRC's diplomats. Laborious searches through voluminous published records of the institutions yielded mostly predictable political commentary that could have more easily been found in the *People's Daily* or *Beijing Review*. Kim has augmented the readily accessible materials in several ways. First, he has subjected the PRC's public behavior to an impressive statistical scrutiny, the results of which are set out in some thirty-seven tables, seventeen figures, and eleven appendices overall. Second, he interviewed over 100 international civil servants and diplomats who could in some way bear witness to the PRC's private activities.[7] Finally, he has neglected neither administrative nor social aspects of Chinese participation, those questions of budgets and personnel, banquets, and personalities which are by no means unimportant in multilateral diplomacy.

5. S. KIM, *supra* note 4, at 4–5.

6. Much of chapter 8, "China and International Legal Order," appeared in Kim, *The People's Republic of China and the Charter-Based International Legal Order*, 72 AM. J. INT'L L. 317 (1978).

7. S. KIM, *supra* note 4, at 503–08 (Interview Schedule).

Thus fleshed out, the bare record takes on more meaning. Informed by the consensus of diplomatic contemporaries that the Chinese representatives set much store by their words and principles,[8] for instance, one views otherwise innocuous statements in a different light. Armed with behind-the-scenes accounts of meetings and commentary on the interactions of the participants, one can proceed to a more substantive analysis of votes and other actions than even Kim's own intricate statistical tables can provide. Sensitized by the comments of long-time observers of the Chinese and of the United Nations, one can begin to see patterns in the minutiae that Kim has culled from the paper record. As a result, Kim appears to have created one of the most complete compendia of the PRC's behavior in international organizations currently available, and for that feat alone he deserves high praise.

Nevertheless, the empirical section is not beyond criticism. Occasionally, Kim's methodology obscures an otherwise adequate analysis of a particular situation. Kim also displays a tendency to view the 1971-1976 period as a constant, showing an insensitivity to the vagaries of Chinese politics. Infrequently, his extensive quantification of data seems excessive, leaving the reader questioning the need for, and significance of, a given table. For the most part, though, his empirical study succeeds.

His introductory commentary on the PRC's image of world order and his closing remarks on WOMP do leave somewhat more to be desired. In a thirty-page essay on the traditional order, he hits the high points — Confucian harmony, the tribute system, the treaty system, and China's reaction to the West.[9] The failure to include other crucial components of the traditional order, such as the concept of the mandate of Heaven, only serves to demonstrate that this overview cannot substitute for the fuller treatment offered by the more specialized works to which he refers.[10] His choice of the Maoist vision of the world as the contemporary counterpart of the traditional set of concepts is, by itself, troublesome. Certainly, Mao's world concepts were central to Chinese foreign policy during the 1971-1976 period to which Kim addresses himself. Even so, Mao was never the sole architect of the Chinese conceptual structure. In light of recent disclosures and historical revelations since the downfall of the Gang of Four,[11] one might have expected some attention to the extent to which Mao's concepts

8. *Id.* at 120–21.
9. *Id.* at 19–48.
10. *Id.*
11. The last two and a half years have seen varying accounts of how much authority was wielded by Mao Zedong during the years immediately preceding his death in 1976. The influence of the so-called Gang of Four, Jiang Qing, Wang Hongwen, Yao Wenyuan, and Zhang Chungiao, on foreign policy, as well as on domestic politics, is still being debated in the press and on the walls of the PRC.

prevailed during the political turmoil of the period under examination. Similarly, greater notice of the international impact of the domestic political events of the time might have added to this outline of the current Chinese conception of world order.

Kim's consideration of WOMP is perhaps better assessed by one schooled in its premises, since the system, as employed by Kim, does not immediately recommend itself to the general reader. As Kim explains it, there are four planetary values (PVs) to be considered: the minimization of large-scale collective violence (PV_1), the maximization of social and economic well-being (PV_2), the realization of fundamental human rights and conditions of political justice (PV_3), and the rehabilitation and maintenance of environmental quality (PV_4).[12] In what he calls "this final appraisal . . . made within the normative framework of a preferred future for mankind,"[13] the PRC ranks high on PV_2, PV_3, and PV_4, while commitment to PV_1 is problematic.[14] Kim's final comments on the symbolic activism and substantive passivism of the PRC's diplomacy seem somewhat more relevant in weighing the facts as earlier presented.[15]

The WOMP assessment brings home the most salient difficulty with Kim's book: it is nearly three years out of date. On one level, this indicates that Kim has not had the benefit of subsequent scholarship on numerous issues. More substantively, later events raise questions about some of Kim's conclusions. The PRC's recent Vietnamese endeavor, for instance, would probably render Kim's finding on PV_1 more negative. Vice Premier Deng Xiaoping's showmanship on his Japanese and United States tours[16] may influence the activities of other Chinese diplomats in their multilateral behavior, giving the lie to the low profile that the PRC and its representatives took during the period studied by Kim. The PRC's acceptance of assistance from the United Nations Development Programme (UNDP)[17] marks a departure from past practice and one that may signal other changes in the level and nature of the PRC's activity in international institutions.

While perhaps not especially well suited to extrapolation into the present and the future, Kim's book is uniquely useful in interpreting the events that have taken place since he researched and wrote it. It

---

12. S. KIM, *supra* note 4, at 471.
13. *Id.*
14. *Id.* at 491.
15. *Id.* at 491–501.
16. China's Vice Premier Deng Xiaoping visited Japan in 1978, and the United States in January, 1979.
17. The Governing Council of UNDP, at its meeting in January, 1979, approved a new $15 million technical cooperation program for the PRC for the period 1979–1981. 16 U.N. MONTHLY CHRON., Feb. 1979, at 68–69.

enables us to see the extension of UNDP assistance as noteworthy, for example. It also serves to enliven the already animated predictions for the PRC's possible participation in international financial institutions,[18] as it casts doubts on the continuing validity of those fears of disruption which preceded the PRC's entry into the United Nations.

In sum, Kim's work should help us to take a more realistic view of the PRC's current world image, by reference to the reality of the immediate past rather than to the assumptions of an earlier age. It represents a welcome addition to our knowledge of Chinese behavior in the international sphere. That his analysis does not always match up to the high level of his research does not detract from the value this work holds for students of the PRC, international law and organizations, and world order.

*Natalie G. Lichtenstein**

---

18. The PRC has not been invited to participate in four specialized agencies of the United Nations: the International Monetary Fund, the International Bank for Reconstruction and Development, the International Development Association, and the International Finance Corporation, nor does it participate in the Asian Development Bank. The ROC continues as the Chinese representative in those institutions.

*Attorney-Adviser, Office of the General Counsel, United States Department of the Treasury. The views expressed in the review are those of the author and not those of the United States Department of the Treasury.