FISCAL AND MONETARY POLICY
Fiscal - State Revenue Needs and the Unitary Tax
Monetary - Effects of All-Savers Certificates and IRAs

INTERNATIONAL ARRANGEMENTS
Economic/Commercial - U.S.-Caribbean Investment
Political/Military - Swedish-U.S.S.R. Relations
Social/Cultural - Nuclear Disarmament Protests in Europe

DOMESTIC ISSUES
Values - Community Protection of the Young
Human Dynamics - Disunity and Growth of the Military in Nicaragua
Resources - U.S. Health Care System

NORTH AMERICA
Canadian and Mexican Foreign Investment Policies

EDITORIAL
Multinational Corporations
The Dean Rusk Center was established in 1977 to foster interdisciplinary research, service and education concerning institutions and processes basic to efficient intercourse among nations. U.S. fiscal and monetary policy has separate emphasis, due to its increasing impact upon international commerce. U.S. trade and investment in a world environment remains the primary focus of its study and policy recommendations sponsored by state and federal entities. The Center also recognizes that internal dynamics of nations remain the major determinant of international relations and that domestic concerns about the quality of life, stability and efficiency will continue to vie for dominance in determining a nation's posture in world affairs. Thus, much of the Center’s data collection and analysis dwells on domestic events of nations and diverse disciplinary explanations of their presence and evolution.

Admittedly, the interactions of fiscal and monetary policy, international arrangements and domestic events cannot fully be analyzed in a specific geographic or subject context. Nevertheless, many of the Center’s policy development activities concentrate on the North American region and related subjects of agriculture, national development, business-government relations and public governance. These bi-weekly briefings reflect the convergence of the Center’s diverse activities and interests.

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Facts and details of events addressed in Briefings are gathered through a scanning of major daily newspapers and weekly periodicals, which are cited throughout each article. Sources of related policy and disciplinary material appear in a listing following each article. The purpose is to link facts with policy implications and academic points of view in order to present an integrated and in-depth approach to current issues. Views expressed are not necessarily those of the Rusk Center.
I. FISCAL AND MONETARY POLICY

A. FISCAL - STATE REVENUE NEEDS AND THE UNITARY TAX

Uncertainties surrounding Reagan’s “new federalism” have brought vocal opposition from state governors and a search for alternative revenue sources. Western governors, under the aegis of WESTPO (Western Governors Policy Office), have called on President Reagan to curb further trimming of block grants and have vowed to pursue a unified “affirmative strategy” in dealing with future federal budget cuts (Wash. Post, 11-8-81, p. C6; Chr. Sci. Mon., 11-9-81, p. 5). At the request of some states, the Supreme Court has agreed to consider the contested right of states to require international companies to pay taxes on a unitary basis, whereby all a company’s dividends, interest, and foreign exchange gains are included in apportionable business income (J. Commerce, 11-10-81, p. 34). Supreme Court action should clarify an issue generating annual court disputes (Wall St. J., 11-10-81, p. 6). Both events illustrate the genuine alarm that exists over the ability of most states to absorb more fiscal responsibility.

The states have already sustained large reductions in revenues flowing from the federal government, with more than 70% of enacted federal spending cuts coming from the 14% of the budget that includes grants-in-aid to states and localities (Chr. Sci. Mon., 11-17-81, p. 11). A stagnant economy has cut further into state revenues, although inflation continues to increase the cost of government. California’s $25 billion budget may result in a deficit—something not allowed under California law (Economist, 10-10-81, p. 38). Uncertainty about future budget cuts has made public works planning difficult; and in many instances, localities are neglecting service maintenance. Financing needed investment is not only more expensive because of high interest rates, but also because municipal bonds must compete with new tax exempt investments. Further, lower federal tax rates make tax exempt bonds less attractive to their traditional purchasers.

To meet many of these shortfalls, 30 states have raised taxes this year (Economist, 10-10-81, p. 38). Most have had to penalize their own residents with higher general sales taxes and taxes on gasoline, cigarettes and alcohol. Additional proposals include: (1) distributing energy severance Taxes among all states, (2) making state and local bonds more competitive by issuing taxable bonds at market rates with federal subsidy for the higher interest rates, and (3) imposing excise taxes on user fees (Chr. Sci. Mon., 5-11-81, p. 24). Each proposal has its own drawbacks; the federal government, for example, is also presently considering excise taxes and user fees as revenue sources for itself. In other instances, most notably with the unitary tax, some strongly suspect that the administration’s “new federalism” is inconsistent with other policy directions it is taking. That is, in promoting the independence of business and industry at the same time it advocates greater state control of public-sector functions, the administration could impose upon the states’ ability to raise funds to carry out their new responsibilities.

Currently pending before the tax-writing committees of the House and Senate are two bills (HR 1988 and S659) designed to restrict states’ ability to use a global income reporting system to assess taxable income of international corporations (U.S. Export Mag., 10-27-81, p. 32). This unitary tax method involves an assessment mechanism that includes a prorated share of income earned outside the state but related to the activities of the in-state corporation. The California congressional delegation recently came out strongly against the legislation that would prohibit such unitary taxation. It is the states’ contention that this method is necessary to prevent multinational corporations from sheltering taxable income by shifting profits to affiliates in low-tax countries. The revenues at stake can be quite large. New York has begun using a worldwide calculation for all companies, and revenues from this industrial group are estimated to increase by $75 million to $105 million (Wash. Post, 11-22-81, p. F1). U.S.-based multinationals have been lobbying hard to have the two bills passed. Aside from their own interests, they argue that it will adversely affect foreign investment
In the U.S. Moreover, they contend that the technical administrative problems of dealing with different currencies, accounting systems, and risk profiles are too large to be simply accommodated in a unitary tax-based structure. Whatever the outcome, it is clear that further state efforts at innovative revenue raising and less passive acceptance of future federal budget cuts can be expected.


B. MONETARY - EFFECTS OF ALL SAVERS CERTIFICATES AND IRAS

Deregulation of the banking industry initiated in increments during 1980 has caused great anxiety about the impact of competition on the capital strength of various classes of financial institutions, especially thrifts. Further, high interest rates and substantial inventories of long-term, low-interest loans are now threatening the financial integrity of many savings and loan associations. To increase the flow of needed capital to these institutions the federal government has modified tax policy on certain types of interest payments and changed banking regulations to provide thrifts greater latitude to compete with non-regulated institutions (Ch. Sci. Mon., 11-3-81, p. 10; Wall St. J., 11-10-81, p. 10).

Since January 1, 1981, thrifts have been allowed to compete with banks for interest-bearing checking (NOW) accounts. In addition, the Economic Recovery Tax Act of 1981 authorized thrifts as well as commercial banks and credit unions to issue within 15 months of October 1981 one-year All-Savers Certificates whose interest is tax exempt up to $1,000 (or $2,000 on a joint return). The same act also authorized a broad array of financial institutions to market individual retirement accounts (IRAs) that allow patrons to create a pension with up to $2,000 of their gross income yearly and defer income tax due until withdrawal at time of retirement. Finally, the Federal Home Loan Bank Board has aggressively encouraged large, healthy thrifts (and, perhaps later on, other types of financial institutions) to accept "package" purchases embracing several all-savers plans all along with a single thrift located in a growth market, like Florida or Texas, where the sufferer wants to facilitate market diversification and expansion (Bus. Wk., 12-7-81, p. 39).

These efforts were intended primarily to re-capitalizing a housing industry whose slump has severely harmed material suppliers, especially in the Northwest. The financial as well as psychological well-being of workers in these related industries appears to be reaching the limits of their resilience. Moreover, banks, especially in smaller communities, are rapidly appearing insensitive to community needs in the eyes of many citizens who do not appreciate the tight linkage between consumer lending rates and bank capital availability and costs. More seriously, numerous small banks that responded to consumers needs contrary to conservative traditions now face closures that could stimulate further public depression and diminish "personal" banking services. If such depression and depersonalization take deep root, a return to normalcy is unlikely despite economic recovery and a plethora of government incentives (Bus. Wk., 1-11-82, p. 93).

The prospects of enduring damage to familiar financial structures have been tempered by the federal initiatives this year to reenlist the capital stock available for housing and improve the liquidity of thrifts. Moreover, they will gradually facilitate capital mobility
between financial institutions and among investment instruments within such institutions. Given the large number of customers potentially influenced by these initiatives and the current inability of many institutions to endure major, immediate discontinuities in customer behavior, the multi-faceted character of this year’s initiatives seems well-suited to allow all types of financial institutions to adjust gradually to the new fiscal and monetary environment now facing the country. Broad-scale competition based on new investment incentives inherent in IRAs will encourage innovation in mass marketing of financial services, while the moderate competition authorized between thrifts and banks concerning NOW accounts will insure gradual synchronization of the two banking traditions that have had disparate origins and missions (Bus. Mk., 11-15-81, pp. 140-146).

Given that fiscal and monetary changes at the domestic and international levels call for a return to the traditional structures and practices of financial institutions, will rearrangements now in process deliver needed services more efficiently? Theory says yes. Competition between different forms and sizes of institutions should separate the weak and strong and eventually eliminate the former. Competition among the strong will create new and better services for retail and industrial customers. Unfortunately, government initiatives, so far, cast doubt on whether the environmental requisites underlying such theory shall be allowed to exist. Certainly, government-sponsored mergers will have the propensity to be shaped artificially to accommodate political imperatives. In addition, it is unlikely full-scale interstate banking will be forthcoming as long as small but numerous community banks resist a loss of identity. Without the license to operate on a coordinated basis across the country as well as to achieve the ultimate economies of scale, optimal serving of the financial needs of multi-unit industrial customers will remain illusory (Bus. Mk., 1-11-82, pp. 100-101; 11-15-81, p. 177; 7-13-81, pp. 55-61).


II. INTERNATIONAL ARRANGEMENTS

A. ECONOMIC/COMMERCIAL - U.S.-CARIBBEAN INVESTMENT

The Reagan administration's desire to see direct private investment play an increasing role in third world development has spawned a number of initiatives. The Overseas Private Investment Corporation (OPIC) has made substantive agreements to insure US$520 million worth of joint ventures between the United States and Jamaican firms. Product areas include agriculture, food production, tourism, manufacturing, and mining. These results follow a mission to the island nation by 24 U.S. business leaders sponsored by OPIC (J. Commerce, 11-10-81, p. 7A). A similar joint business-government mission commenced in early January to Cameroon, Ivory Coast, Nigeria, and Morocco. The mission, headed by Commerce Secretary Malcolm Baldrige and Agriculture Secretary John R. Block, includes chief executives of 30 U.S. firms and officials of the State Department, the Export-Import Bank, the Agency for International Development, and OPIC (J. Commerce, 1-6-82, p. 5A).

While the African trip is to countries with considerable investment potential, the administration's primary focus appears to be on the Caribbean. Initiatives undertaken in this region include measures to rationalize transportation costs, techniques to overcome the scarcity of foreign exchange, and on-site health inspection of agricultural produce.
The variety of criticisms highlights an enduring consistency problem for the Reagan administration as it seeks to carry ideological commitments to real-world circumstances. Investment risks can be mitigated by organizations such as OPIC, but expansion of its outlays is funded in order to lower risk conflicts with domestic budgetary considerations. Selective tax incentives designed to promote investment in targeted regions not only raise the specter of international favoritism, but also leave considerable scope for manipulative foreign policy actions based upon political considerations. The concerns expressed by Latin American countries illustrate this point and show the need for a multilateral approach, especially in the Caribbean, that accords due recognition of the variety of sensitivities there. The real danger for the present administration is that if an increased flow of U.S. private investment is not forthcoming, possibly as a result of domestic market uncertainties, then President Reagan will be left without a cogent alternative that can be rapidly instituted to forestall foreign policy setbacks.


B. POLITICAL/MILITARY - SWEDISH-U.S.S.R. RELATIONS

An international incident involving the exposure of surreptitious activity by the Soviet navy in Swedish territorial waters and Swedish consideration of the possibility of changing defense procurement
patterns represent new developments in Sweden's foreign and defense policies. The presence of a stranded submarine equipped with nuclear-tipped torpedoes and a Soviet intelligence officer on board in a sensitive military testing region has raised questions about the sincerity underlying the two-year Soviet campaign for the creation of a nuclear-free zone in northern Europe. The Soviet proposal involved a pledge by all participants that they would not deploy nuclear weapons in northern Europe, the pledge being guaranteed by the Soviet Union. This incident, coupled with the decision by the Swedes to purchase important aircraft components and weaponry from the United States, may signify a change in Sweden's status as Europe's only neutral nation entirely responsible for its security.

Though the creation of a nuclear-free zone in northern Europe was first proposed by the Soviets in the late 1950s and since then by the Finnish government, it has only recently gained popularity in Sweden, Norway, and Denmark as a result of the climate of defense that emerged in the 1970s. In Sweden, post-War II economic expectations were constantly met, producing a model welfare state based on social consensus and indigenous natural wealth. Since the 1970s, however, Sweden's economy, reliant on exports for continued growth, has been adversely affected by the rising price of oil, which it imports heavily, at a time when the government has expanded its commitment to provide assistance to developing countries. High production and wage costs have reduced the number of Swedish export markets, but no compensating progress in products and techniques has emerged. Even though Sweden still spends as much of its GDP on defense as NATO countries, it has reduced defense spending from 4% to 3.5% of GDP over the past five years; and spending is no longer keeping pace with the rising costs of new generations of weaponry, particularly fighter aircraft. Demands for continued distribution of national earnings have called forth corresponding desires for the

continuation of peace and stability in the region in order for economic prosperity to grow at as high a rate as external economic conditions will allow.

If Sweden decides to accept U.S. Secretary of Defense Caspar Weinberger's offer (made in a visit to Sweden shortly before the submarine ran aground) to sell jet engines to Sweden, then it will probably emphasize in future policy pronouncements its mediating role between East and West to compensate diplomatically for the increased reliance on extra-natural sources for important military parts.

But, allegiances, this choice would represent a compromise between military planners, who advocate an increase in defense strength, and economically-minded policymakers, who prefer to continue the reduction in spending that began over fifteen years ago. Though the submarine incident has compromised the credibility of the Soviet proposal for a nuclear-free zone in northern Europe and increased the appeal of renewed military strength in Sweden, the revised perception of Soviet intentions in Scandinavia may soon succumb to an intensification of the popular desire for stability and prosperity. Thus, the controversy within the region over how a nuclear-free zone should be created—whether it should be part of a general East-West arms reduction proposal or merely confined to the Nordic area—will be decided in favor of the latter course if the Soviet proposal is accepted. Though the maintenance of a unique Nordic identity as a mode of stability is a primary interest of all countries in the region regardless of the role the superpowers play there, a unilateral Soviet guarantee against the deployment of nuclear weapons would not deter the Soviets from wishing to maintain their status as the only country to station and deploy nuclear weapons in northern Europe.


C. SOCIAL/CULTURAL - NUCLEAR DISARMAMENT PROTESTS IN EUROPE

In late October Bonn, Brussels, London, and Rome were the scenes of mass demonstrations protesting NATO’s decision to deploy nuclear weapons in western Europe. Although the gatherings were scheduled in conjunction with U.N. Disarmament Week, the vast number of participants (at least a quarter of a million in several cities) raises the question whether this anti-nuclear movement is part of a larger groundswell of dissatisfaction and protest linked to last year’s series of riots in England, Holland, Germany, and Switzerland. Notwithstanding the obvious contrast between the two—the earlier unrest seems to have been largely economic in nature, growing out of dissatisfaction with housing shortages, high unemployment rates, and recessionary trends, whereas current demonstrations are focused on a patently military issue—it is arguable that both phenomena are rooted in a loss of identity with a local and national community, in feelings of anomie, alienation, and powerlessness.

Europeans have a growing sense of economic vulnerability, not only to OPEC’s control over oil prices and supplies but also to U.S. monetary and fiscal policies. More importantly, international political relations have deteriorated since the breakdown of détente after the Soviet invasion of Afghanistan two years ago. Subsequently, Europeans have come to feel out of control of their destiny (N.Y. Times, 11-15-81, p. 43; New Republic, 11-11-81, p. 20; German Tribune, 10-25-81, p. 4; U.S. News, 11-9-81, p. 23). Proof by negation may be found in France, whose nuclear capability is often cited as the source of a sense of national power that has inhibited the development of a large French anti-nuclear movement.

According to mass theory (a body of propositions developed during the 1950s to describe the lumpen proletariat found in Europe and in isolated pockets of the U.S.) the critical factor in the origin of the “mass man” syndrome--anomie, alienation, and powerlessness expressed in sporadic, non-instrumental protests—is the absence of integration into middle-level organizations in society. This factor, too, appears to be present: e.g., young people in West Germany do not feel the Social Democratic Party adequately articulates their interests (German Tribune, 10-11-81, p. 5; 10-18-81, p. 3; Wall St. J., 11-15-81, p. 54; N.Y. Times Magazine, 11-15-81, p. 118). Finally, some analysts find evidence of the escalating nature of protest described by mass theory in the build-up of issues in Europe during the last decade. The women’s movement, concern for injustices in the third world, ecology, recession, and now nuclear weapons have provided alienated youth an array of unrelated issues around which to rally their general sense of malaise (N.Y. Times, 11-5-81, 14; N.Y. Times Magazine, 11-15-81, p. 117).

Despite the cogency of this argument, there is much counterevidence. Unlike the spontaneous turmoil last summer, the October demonstrations were well planned. Although allegations have been made that the political leadership responsible for planning was motivated by cynical power considerations or that funds for demonstrations come from communist parties, particularly East Germany’s (German Tribune, 10-18-81, p. 5; Wall St. J., 11-16-81, p. 31), these unsubstantiated charges are counterbalanced by the fact that hundreds of organizations, including Protestant church groups, members of the German and Italian socialist parties, and former nuclear energy activists, cooperated to manage these massive yet peaceful demonstrations (Economist, 10-31-81, p. 16; New Republic, 11-11-81, p. 19). German newspaper reporters found that it was the first demonstration for west participants (German Tribune, 10-25-81, p. 4). Furthermore, France’s exceptionalism has not been replicated in Britain, which also possesses a nuclear capability, and recent polls indicate anti-nuclear sentiments are on the rise in France (Economist, 10-31-81, p. 59). Perhaps most importantly, the anti-nuclear movement has a pragmatic quality that distinguishes it from previous
mass movements (Wall St. J., 11-15-81, p. 30). Finally, mass theory itself has never earned academic credibility through empirical verification, largely because of inherent logical and conceptual ambiguities.

Although the possibility of a connection between the two series of protests is merely speculative at this point, the existence of such a linkage would have serious implications for U.S. policy. If the current demonstrations are grounded in alienation and grief, their focus on nuclear disarmament will probably be short-lived but potentially violent and destabilizing. It would indeed be difficult for the U.S. to frame policy in terms adequate to counter these random effects. Addressing the critical factor of inadequate political socialization and articulation of concerns is essentially a domestic problem over which the U.S. can exert little influence. Perhaps the most effective strategy the U.S. could pursue would be one that enhances Europe's sense of power. Resumption of serious negotiations is one step widely advocated; another is effective communication of the American position to Europeans to counter the developing negative image of America (Wall St. J., 11-30-81, p. 30).

If, as is more likely, these are discrete phenomena, with the anti-nuclear movement characterized by political organization and practicality rather than psychological instability and ideology, then the U.S. should find it easier to fashion policy accommodating European demands and interests because these would be more consistent and better articulated. Ironically, however, a disarmament resolution with the U.S.S.R. might prove more difficult to attain if a tightly focused, highly organized European opposition movement is exerting pressures from outside the bargaining process.

"Up from Reaganism," T. Hughes, Foreign Policy 44:3-23, Fall 1981.


III. DOMESTIC ISSUES

A. VALUES - COMMUNITY PROTECTION OF THE YOUNG

The right of a community to establish local norms which vary from national standards is a familiar point of contention in the long-running battle over censorship of artistic and literary works. Towns and states have often argued that their children and adolescents should not be exposed to materials the inhabitants consider potentially harmful, even though these same materials are found acceptable in New York, Los Angeles, or Atlanta.

The same principle underlies the controversy over apparently disparate issues. Last June, the trustees of Morton Grove, Illinois, a suburb of Chicago, enacted one of the nation's toughest handgun control ordinances. Confronted by an application to open a gun shop in a shopping center located along a commercial strip used frequented by the city's teenagers, the trustees feared the shop's presence could prompt teenagers to experiment with handguns. They first moved to ban firearm dealers from Morton Grove and then, in a stop which surprised and threatened the powerful National Rifle Association, expanded the law to bar possession of handguns within the city limits except by police, gun clubs, and antique gun collectors (Nash, Post, 11-8-81, p. 1).

Similar protective instincts have been accused as the burgeoning $5 billion per-year computer-game industry has attracted more and more players, particularly adolescents. Critics of the games and video arcades insist that they encourage children to squander their time and allowances and that they foster violence. Though solid evidence of the harmful effects of the video craze is not available, communities as diverse as Boston and Snellville, Georgia, have banned the arcades or
limited access by minors (Newsh., 11-16-81, p. 90-94). When the city of Mosquite, Texas, concluded that video arcades provided an unacceptable environment for ununsupervised youth, it prohibited children under 12 from playing in an arcade unless accompanied by an adult (Chr. Sci., Mon., 11-12-81, p. 3).

Maryland, complex legal and constitutional issues surround the efforts of Morton Grove's and Mosquite's city leaders. In November the Supreme Court heard arguments that the Mosquite ordinance is unconstitutional and will consider, among other questions related to the case, whether minors under 17 have an unqualified right to play coin-operated amusements in commercial establishments (U.S. Law Wkly., 11-17-81, S84399; 9-25-81, S843869). Opponents, with the financial assistance of the National Rifle Association, challenged Morton Grove's handout ban in U.S. District Court in Chicago on the contention that it violates the second amendment to the U.S. Constitution, which guarantees the "right of people to keep and bear arms" (Nash. Post, 11-8-81, p. 1). The initial court decision upheld the ordinance, but the ultimate fate of the ban will hinge on judicial interpretation of whether the constitutional guarantee applies to individuals or to "people" organized institutionally, e.g., as state militia and local police (Nash. Post, 11-8-81, p. 1; N.Y. Times, 12-20-81, p. 9).

While the courts wrestle with legal intricacies, the communities must come to terms with tradeoffs implicit in their decisions which have far-reaching implications for national as well as local quality of life. Morton Grove banned the sale and possession of handouts to protect its children from violence and to insulate them from the influence of the weapons. Some citizens protested that the "honor system" will be lost defenseless while criminals remain illegally armed (Nash. Post, 11-9-81, p. 1). Any ill effects of video games may be mitigated by limiting children's access to arcades, but some find the games an important emotional release from frustrations at school or at home (Nashw., 11-15-81, p. 91). Controls will affect these young people as well as limit the freedom of families that view the activity positively. Similarly, school boards have often purged libraries of allegedly vulgar works such as Kurt Vonnegut's Slaughterhouse Five. When taken from library shelves to protect the impressionable from the "obscene," Slaughterhouse Five can no longer impart its vivid message of the horror and futility of war to developing adolescents who might listen.


B. HUMAN DYNAMICS - DISUNITY AND GROWTH OF THE MILITARY IN NICARAGUA

A signal feature of the Sandinista government of Nicaragua over the past few months has been its increasing emphasis on militarization. The latest additions to the army's capabilities are coming from the French, who in December signed a $150 million contract for non-offensive military items and for training a number of pilots and naval officers (Nash. Post, 1-9-82, p. A1; 1-14-82, p. A1). Previously, Nicaraguan received arms and equipment only from non-western countries. The buildup in military personnel within the country is impressive; recent estimates have been of an army 30,000 strong and a militia numbering 50,000 (U.S. News, 12-21-82, p. 20)—a large force by Central American standards. This militarization has taken place as a counterpoint to two other developments: (1) the increasing sense of threat from the outside—both from exiled Nicaraguans living in Honduras and the U.S., and from the U.S. government itself (Nash. Post, 1-10-82, p. A14; N.Y. Times, 1-10-82, p. E2); and (2) the growing conflict between the government and the
private sector, typified by the arrest and imprisonment of three prominent businessmen who had expressed public dismay with the ruling junta (Chim. Sci. Mon., 11-4-81, p. 1); by a mob attack, apparently with government foreknowledge, on the house of the industrialist leader of an opposition party (Newsweek., 11-16-81, p. 59); and by the frequent closing of La Prensa, the country’s independent news organ (Time, 12-14-81, p. 48). Underlying all these events and fears is an economy that is not functioning. After the severe dislocations of the revolution, the ruling junta had counted on 1981 being the “Year of Production”—in which economic activity would begin to alleviate the country’s ills. Instead, Nicaragua’s worsening situation led the government to apologize on New Year’s Day for its failed attempt to do too much too fast (Miami Herald Tribune, 1-2-82, p. 12). While the admission of failure carries with it a realization of the difficulties of governance, it does not necessarily imply an understanding of how to stem the currents leading to greater deterioration of the social and economic fabric of the nation.

Prior to the overthrow of Somoza in July 1979, Nicaraguan society enjoyed a market cohesionness. In contrast to other authoritarian figures, Somoza competed directly with the private sector in his widespread business interests. Business people across a broad economic spectrum had, in defense, developed strong organizations to combat his potential dominance of industry and the markets. They were in accord with other significant segments of society— including the peasant guerrillas fighting under the banner of Sandinismo—that Somoza must go. After his capture, the fledgling Sandinista government committed itself to political pluralism and a mixed economy; and in the early days of power, Nicaraguan business leaders, among them ones now in jail, could be found in the halls of Congress lobbying for U.S. aid on behalf of their government. Accord was not long-lived, however. The realities facing the junta included a seriously damaged economy; a populace encouraged by the fervor and sacrifice of revolution to expect immediate, dramatic improvement in their lives; and the lack of a coherent plan to surmount those problems. The initial result was confusion and a burgeoning bureaucracy with loyalties divided among the members of the three-man junta.

and the nine-man directorate of Sandinista commanders that hold power. Commented Lawrence Pizzullo, former U.S. ambassador to Nicaragua, “This isn’t a government but a series of field officers with a thin veneer covering the anarchy” (Walt St. J., 9-15-81, p. 1). Directives from various authorities were often contradictory, and could and did change on a daily basis, along with the people who were to carry them out. The dimensions of confusion were such that U.S. aid packages earmarked for Nicaragua were not given because no plan could be devised for their expenditure. A complicating factor in the Sandinistas’ increasing inability to govern was the destabilization of neighboring El Salvador, where they had strong natural ties to the guerrilla movement. With both Nicaragua and the U.S., ideologically unable to compromise on that issue, the possibility of U.S. intervention in Central America seemed to become real to the Sandinistas (N.Y. Times, 1-10-82, p. E2).

In January 1981 U.S. aid to Nicaragua was suspended. Some support has continued from other countries, particularly Mexico; but this has been small in proportion to the country’s needs, given the steep drop in both exports and their price levels and the rising cost of imports. Hopes for slowing the trade deficit growth dim with the dwindling supply of hard currency to buy necessary imports such as raw materials and spare parts, much less to purchase expanded export production capacity. Moreover, inflation and unemployment are further damaging the economy (Walt St. J., 9-15-81, p. 1). While no general exodus of skilled workers and professionals has occurred, one estimate is that perhaps 10% of the country’s 250,000 have left (U.S. News, 10-12-81, p. 33).

The 1979 unity of distinct social groups has not withstood the pressures engendered by their cultural distance and diverging goals, by the inexoricity of the ruling group, by economic disarray and an adverse international climate. Although people of good will in and out of government continue to search for a moderating course, divisiveness and extremism grow as positions harden. The private sector has been unwilling to commit itself to capital investments without assurances concerning political freedoms and private property rights; but an insecure
junta feels less and less able to give these. Instead, along with its attempts to aid the nation's poor through health and education programs, subsidization of basic necessities, and land redistribution, it has postponed elections until at least 1985, punished dissent, engaged in apparently capricious confiscations of businesses and threats to members of private business associations, talked increasingly in terms of class struggle, and placed great emphasis on building its military capabilities (Wall St. J., 9-15-81, p. 1; U.S. News, 10-12-81, p. 33). At a number of different levels, the situation in Nicaragua poses difficult choices for its government, its citizens, and its western neighbors. For each, cooperation with the other may hold great risk or require disturbing compromises of principle. Against these considerations must be weighed dangers inherent in the complete removal of influence in a volatile political climate.


C. RESOURCES — U.S. HEALTH CARE SYSTEM

Among the most important social welfare proposals that will come from the Reagan administration are measures to cut medical expenditures and to end the concentration of health planning authority in the federal government. Medicaid and Medicare costs have been rising faster than the capacity of states to pay their share or the federal government's present willingness to pay. The federal share of health funding has risen from 51% in 1965 to 67% in 1979, with Medicaid growing from $1.9 billion to $12.7 billion during the same period and expected to rise more in the future unless restrictions are placed on its growth. This has led to office of management and budget proposals to reduce the budget for health planning and resource development by repealing the Health Care Financing Act and to permit competitive forces within the medical community to determine the quality and availability of medical services (Nat'l J., 5-14-81, p. 440). The administration has also proposed to reduce costs by enabling insurers to formulate cost-cutting incentives for patients, doctors, and hospitals (Wall St. J., 8-25-81, p. 52).

The new guidelines contained in the 1981 Budget Reconciliation Act that restrict Medicaid reimbursements will give states the responsibility of administering Medicaid. Ultimately, states will have to restrict Medicaid budgets and lower reimbursements to hospitals, thereby forcing those and other providers to charge patients (Nat'l J., 1-10-81, p. 44; Modern Healthcare, 11-11-81, p. 48). Opponents of the abolition of federality funded state planning agencies and federal health care funding in general include large-scale employers in business and industry who cooperate with state planning agencies in maintaining employed health plans; labor unions with health care plans through the companies where members work; insurance companies; and the recipients of the services (Nat'l J., 6-20-81, p. 1110). The leading proponent of the reform comes from the administration itself. As director of OMB, David Stockman, former member of the House committee concerned with health care policy, was finally able to put forth a proposal he has advocated for years to restructure the health care incentive system along market-oriented lines. The American Hospital Association and the American Medical Association also agree with the administration's approach (Nat'l J., 4-28-79, p. 689; 5-14-81, p. 441).

Two interacting factors have contributed to rising health costs in America: an increase in demand for services because of the availability of third-party payments and the existence of fee-for-service and cost-based reimbursement systems that lack inducements to provide less expensive medical care. Greater incentives exist for the purchase of

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product-innovative technologies that can be bought with funds from retrospective cost-based funding than for the efficient use of existing equipment and procedures. Since health care is a market in which consumers possess imperfect knowledge completed by the medical profession, which creates additional demand, third-party expenditures have risen with this artificial increase in demand. One dimension of this phenomenon is the existence of some services that have in the past been provided by households but are now administered by health professionals. Moreover, as more labor and capital are drawn into health care, less is available for producing goods and services in other sectors.

States will now bear the burden of responsibility for financing and administering governmental health care programs. The administration reasons that the pressure states will face from interest groups who must adapt to reforms will combine with the requirements of congressional legislation to produce new methods of financing equivalent health care with fewer funds. Interests most adversely affected by deregulation and removal of federal funding from the health care industry should not be alienated from current trends if they continue to receive benefits from the health care industry. In particular, the reaction against deregulation among recipients must not be so extreme that the momentum sets in for the complete removal of market incentives from the health care sector. Health care delivery appropriate to that preceding reforms can be maintained by the more efficient use of existing health care facilities. Among the requirements to meet this goal are a more critical examination of the introduction of new technology into various treatment settings when present techniques and facilities can be used with an acceptable degree of effectiveness and at lower cost; a greater reliance on neighborhoods and households to provide non-professional health care delivery; more dependence on community planning facilities to determine local health needs; and increased attention to preventive health care.


IV. NORTH AMERICA

CANADIAN AND MEXICAN FOREIGN INVESTMENT POLICIES—Several items in the recently announced Canadian budget have given foreign investors reason for limited optimism. The nationalistic policies of the one-year-old New Energy Program (NEP) will not be extended to other economic sectors; procedures of the Foreign Investment Review Agency (FIRA) will be streamlined; and the government will not protect Canadian firms from foreign takeovers by announcing these ahead of time to allow for Canadian bidding (J. Commerce, 11-16-81, p. 1A4). Some signs of a similar change seem to be appearing in Mexico as well. The nomination of Miguel de la Madrid Hurtado, reputed to favor the private sector and foreign investment, has been complemented by a more favorable investment climate for American business, particularly in the field of energy diversification (J. Commerce, 11-19-81, p. 23A).

Although growing pressures from the U.S. public and private sector may have had some influence, the Canadian decision appears to have been motivated largely in response to economic distortions in the energy sector that resulted from Canadianization policies toward foreign investment. According to a recent poll of Canadian Oilfield Manufacturing Association members, sales had dropped 40% since the institution of the NEP (J. Commerce, 10-28-81, p. 6A). Stock prices were also dropping and mergers were increasing as a result of the heavy financial burdens assumed by firms attempting to take over foreign-owned oil companies operating in Canada (Economist, 11-14-81, p. 106; Bus. WK., 10-19-81, p. 6A). (Interest rates in Canada are at least as high as those in the United States, and most of the private takeovers have been financed through borrowing.) Compliance with Canadian Ownership Rate (COR) requirements is also adding to energy firms' costs and administrative responsibilities; in order to qualify for government grants for Arctic
and offshore oil exploration, firms must prove that the true beneficiaries of at least 50% of shares in lots of $50,000 or more are Canadians, not, for example, foreign pension funds with a Toronto mall drop. Establishment of true stock ownership is proving difficult, time-consuming, and costly (Wall St. J., 7-7-81, p. 16). The most important problem is the decline in foreign investment, upon which both Canadian and Mexican economic development are dependent. Recent studies of private sector debt in Mexico indicate that foreign debt stands at a much higher level than previously estimated, US $31 billion rather than US $36.4 billion. High interest rates render this debt particularly burdensome, while the non-renewable nature of oil, Mexico's major export, makes leaders reluctant to increase foreign sales of this product in order to reduce the foreign debt burden (Latin America Wry, Report, 10-30-81, p. 1). Given the developing nature of Mexico's economy, investment must continue to come from abroad.

Foreign investors have been put off by time delays caused by foreign investment review procedures in both Canada and Mexico and by uncertainties regarding the possible spillover of nationalistic policies from one energy into other sectors (Bus. Latin America, 7-10-81, p. 355; 10-7-81, p. 318). Nor do Canadian "performance requirements," calling for the use of Canadian goods in certain contracts, act as incentives to foreign investment. Within the energy sector the low level of compensation offered foreign firms in return for retroactive government acquisition of 25% of value has been a particular sore point for foreign investors who were originally invited to Canada to explore. Other disincentives include a tax increase on "oil" natural gas that will reduce net profits, and extraterritorial application of Canadian rules regarding mergers (U.S. Dept. State Current Policy #318, 10-1-81, p. 4).

Despite the recent indications of changes in Canadian and Mexican attitudes toward foreign investment, other events indicate that optimism should be guarded. The same Canadian budget increased corporate taxes and reduced the capital cost allowance, policy changes that will be disincentives to all investment, domestic and foreign. A recent poll indicated widespread popular support for the NEP (J. Commerce, 10-26-81, p. 6A). The government of Quebec has just won control of the second largest asbestos producer in the province by means of a controversial forced sale. Mexico's Foreign Investment Commission (CIF) seems to have expanded its scope of authority by announcing it will require permits for Mexican purchases of U.S. real estate, a recently burgeoning trade motivated by fears that the peso will be devalued and by the high cost of mortgages and real estate in Mexico. Interest on mortgages is as high as 40% (Wall St. J., 12-2-81, p. 31). In addition, qualification for Mexico's new government incentives to foster growth in the capital goods industry is contingent upon compliance with a stricter form of domestic ownership requirements (nominal cf. bearer shares) that had previously been imposed only in the energy sector (Bus. Latin America, 10-7-81, p. 318).

On a deeper level, the underlying reasons for the initial establishment of Canadianization and Mexicanization policies do not indicate that current reforms are likely to be an about-face. Although these policies have contributed to economic distortions, they were created to overcome imbalances of at least equally serious proportions. Both countries experienced foreign control of extremely valuable, non-renewable resources. Only a year ago Canada's energy sector was 75% foreign-owned (J. Commerce, 10-28-81, p. 6A). Historically, foreign investors have extracted Canada's wealth of natural resources and shipped them out of the country for processing, thereby imposing an opportunity cost on Canada's labor market. In Quebec, for instance, it is estimated that only 9% of asbestos produced is processed in the province (N.Y. Times, 11-29-81, p. 4F). Foreign control of research and development tended to limit and shape the structure of Canada's economic development, perhaps not always to the nation's advantage. The branch plant status of most Canadian manufacturing operations denies local managers the autonomy to diversity trade and production patterns (Canada Wry, 10-28-81, pp. 4 & 5). Thus, when evaluating the nationalistic policies of Mexico and Canada, the United States should regard these not merely as political phenomena or as temporary by-products of national identity crises but
rather as a rational, albeit imperfect, effort to correct certain long-
established economic problems.


V. EDITORIAL

MULTINATIONAL CORPORATIONS - Few economic issues since the Second World War have generated such a xenophobic tangle of opinions as have the multinational corporations (MNCs), with a certain public folklore building up over foreign investment and what it implies. International economic theory has not been able to provide a safe intellectual haven whenever a variety of vested interests propound their views, even though academic interest is lacking. On the contrary, theories seeking to explain international investment and its effects are legion. But as is so often the case with the social sciences, controlling for the multitude of variables is not possible, leaving scope for a range of arguments that may all contain an element of truth.

Intuitively, it seems that conflict between a host country and multinationals operating within it should be minimal because the immediate results tend to be economically advantageous for the country, which not only receives a transfer of physical capital, but also managerial and entrepreneurial skills and access to established market networks.

In a developing country with severe unemployment, the transfer of technical expertise often results in productivity gains that filter throughout the economy. But conflict does occur, much of it stemming from distribution of the benefits. Transnational corporations do behave differently from domestic firms. They tend to produce in tightly organized, highly differentiated capital-intensive oligopolies. Because these firms seek to optimize the economic rent on their knowledge assets and because they have a geocentric outlook and decision orientation, head offices do quite rationally design and implement business strategies that transcend national boundaries and maximize profits worldwide. But many host countries say the "costs" are too high. This criticism takes many forms. In an effort to see bigger returns to domestic labor, the degree of capital intensity of production is often criticized. Further, as many MNCs are dominant employers, they are repeatedly accused of distorting the character of the domestic labor market.

While these economic problems may exist, the most common reason for serious conflict is political. The relative independence of multinationals is a cause of much frustration to host country governments. The presence of foreign capital in a country engenders among government officials a sense of lack of control over national activities. Many see these firms as political institutions exercising decision-making power over key segments of the national economy beyond the jurisdictional reach of the host government. The fact that a government's goals may restrict its choices and that those goals may differ substantially from those of the multinationals and their home-base countries can cause great disputes among host country politicians. For example, the U.S. government's principle of extraterritoriality with regard to the operations of its firms abroad has created numerous problems. In many instances, identification of foreign direct investment with neocolonialism has frustrated politicians and others to divert attention from internal causes of domestic difficulties by blaming them on the presence of large multinationals. It is not useful to dismiss these political factors as irrational, one can convincingly argue that
nationalism is simply a public good which a country has a legitimate right to desire.

Following support from industrial countries and a spirit of compromise from developing countries, the United Nations’ code of conduct for multinational corporations should be in place next year. While this code is voluntary rather than mandatory, the general consensus is that some code is necessary. The code will include guidelines on foreign exchange operations, transfer pricing, and restraint of competition and policies regarding information dissemination to host countries. When discussions began four years ago, industrialized countries were particularly concerned that their home-based multinationals were not singled out for unfair, discriminatory treatment. At the same time less developed countries were opposed to the inclusion of any rules of government conduct. The move to reconcile these polar positions represents a positive step. International agreements among governments will establish ground rules that will transform disputes into legal issues amenable to solution by international tribunals rather than have them remain political issues characterized by emotional and ideological rhetoric.


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Volume 11, No. 2
January 25, 1982