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Fiscal Policy Impacts on Foreign Direct Investments in the United States

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FISCAL POLICY IMPACTS ON FOREIGN DIRECT INVESTMENT
IN THE UNITED STATES

by

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A Thesis Submitted to the Graduate Faculty
of the University of Georgia in Partial Fulfillment
of the
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1987
FISCAL POLICY IMPACTS ON FOREIGN DIRECT INVESTMENT IN THE UNITED STATES

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I. INTRODUCTION

Foreign direct investments in the United States have increased significantly over the last several years. Although not a new phenomenon the acceleration of the growth is noteworthy. In 1980 foreign investors spent $11 billion to acquire or establish businesses in the United States, which increased the foreign direct investment position at the end of the year to 20% or $65 billion. Though the 1980 increase was less than the $12 billion inflow the foreign investment position remains significant. Moreover, there is an increased rate of reinvested earnings by incorporated affiliates.1

In contrast to other countries, political and economic stability in the U.S. have induced foreign investment. Most prominently, Europeans, Canadians and Japanese were attracted by the dollar depreciation in the last five years. However, one of the most important aspects of conducting business in the U.S. is that it offers one of the largest and most lucrative consumer markets in the world, in contrast to many European markets which are approaching saturation levels. The availability of a highly skilled labor force and a narrowing unit labor cost between the U.S. and other industrial countries are other decisive reasons.

Apart from these factors, foreign investments are influenced by a wide range of governmental policies at the federal, state and local levels articulated in laws, implemented by a wide array of agencies. These policies embrace absolute limits on alien migration and investment, reporting and conduct regulations concerning alien
investment activities, and nondiscrimination laws affecting different classes of investment opportunities. Existing legal materials focus extensively on alien migration and investment restrictions as well as taxation of currency controls, antitrust etc. Conversely, subjects like fiscal policy development and implementation, which are of far greater importance to investment decisions, are sparcely addressed in traditional legal materials, although Congress is often involved in deciding, implementing, influencing and responding to such policies.

Increasingly existing and potential foreign investors are seeking direct involvement through lawyers and others in all these legislative processes. Their effectiveness and efficient involvement depend on a detailed understanding of the principles and procedures associated with such policies as well as their diverse impacts on various investment categories. This thesis explores these aspects of fiscal policy in an attempt to facilitate such an understanding on behalf of lawyers.

Fiscal and monetary policies in the U.S. are employed to govern the economic behavior of the public and private sectors. They are both powerful for affecting the overall state of economic expansion or contraction and thus largely define a favorable or unsatisfactory investment situation for foreign investors.

The aim of both policy tools is to influence market vacillations by countercyclical interventions. Whereas different entities claim responsibility for those policies, the Federal Reserve Bank for monetary policy and the federal government for fiscal policy, and whereas both policies are regarded as separate and distinctive tools in economic management, both can be used to achieve similar effects on
the level of business activity. Furthermore, some desirable objectives intended by the government through fiscal policy might fail because of the neutralizing effects of decisions in the monetary area made by the Federal Reserve, which may have been guided by a different standard, e.g. the achievement of a balance of payments.5

Despite these close linkages of monetary and fiscal policy and a necessary coordination of them in order to achieve successful economic results, it would broaden the scope of this paper excessively to look at both aspects. Instead, this thesis concentrates on the influence of fiscal policy on the economic system and specifically on foreign investments in the U.S. It tries to illuminate the importance and characteristics of fiscal policy, the tools of fiscal policy, and the tool's impacts on the investment climate in the U.S. as relevant factors in the foreign investment decision making process.

II. FISCAL POLICY

A. An Overview

Fiscal policy decisions are made at state and local as well as at federal levels. Thus, a foreign investor can be confronted with investment incentives and investment programs initiated by state and local governments to stimulate and promote the local economy. Because
the study of fiscal policy decisions on all levels would go far beyond
the scope of this thesis, it is the intent here to show that a foreign
investor in the U.S. must be aware of the different kinds and origins
of fiscal policy decisions he has to consider and to include in his
decision making process whether or not, where and how to invest and do
business.

Although fiscal policy aspires to some ultimate objectives
associated with monetary policy the latter is distinguishable by the
techniques employed for goal achievement. Monetary policy functions
through control of the money supply, interest rate and certain types of
credits by changing money reserve requirements of member banks,
varying the discount rate and open market operations (the buying and
selling of government securities); whereas fiscal policy works mainly
through altering taxes and/or federal outlays in the budget as well as
through the federal borrowing power. The main instruments for the
federal government's execution of fiscal policy are tax regulations and
the federal budget.

B. The Federal Budget

1. Functions

The federal budget today is the financial indicator of what the
government does or intends to do.? It is a legal document and a finan-
cial plan dealing with expenditure and revenue questions in a specific
time period in the future, called the fiscal year. Though it repre-
sents a huge amount of data, words and figures, the view of the budget
as a simple financial report would be too narrow. The budget is the
written statement of every government, explaining the different alloca-
tion of funds, why they are made and which purposes the government
attempts to achieve with it and which problems it focuses on. Thus,
it is a source of detailed information for the public and to everyone
participating in the budgetary process.

The purpose of the budget can be summarized and classified by the
following functions: a) political; b) economic; c) financial;
d) analytical planning; and e) control and managerial functions. As
the main institutional and functional context within which governments
enforce political ideas and decisions, the budget presents the trans-
formation of political programs into data. Since federal receipts are
limited it is very important as to where and how to spend the money.
The political struggle among the President (executive), Congress
(legislature), agencies and different interest groups can be observed
ey every year during the time the budget is being prepared and considered
by Congress. The overall outcome is a political compromise between
these various powers; but, in essence, it shows the President's "choice
among alternatives." For example, President Carter's budget empha-
sized federal funds on social security benefits and welfare programs,
whereas President Reagan's budget focuses on defense projects and
traditional supply-side oriented economic stimulation.
Another significant task of the budget is its economic-political function. Because government activities and expenditures for services have increased in this century, the economic impact of federal budget decisions has enlarged tremendously, quantitatively and qualitatively. Various reasons for this development can be gleaned by looking carefully at expanding defense needs and international commitments; the shifting of many state and local responsibilities to the national government; the growing demand for governmental services; and the changing attitude of the public towards the use of government to provide security against many economic risks. In addition, the movement in public economics after the 1930s world economic crisis towards a more interventional orientation of fiscal policy underlines the importance of this budget function. Forty years ago, John Meynard Keynes in his famous book, The General Theory Of Income, Employment, And Prices, urged national governments to accept economic responsibility through their respective budget policies. The Employment Act of 1946 provided for the first time that the government ought to use fiscal policy -- expenditure and revenue policies -- to maintain stability of output, employment and prices, which means prosperity and economic growth.

To meet these requirements the federal government tries through the budget to influence aggregate demand, to redistribute income, to stimulate the economy, to keep a full employment level, and to fight inflation. Thus, the budget process often embodies the pursuit of conflicting goals even though the participants realize all desirable
objectives cannot be achieved at the same time with equal effort and result. Priorities have to be made according to the government's political orientation as it interprets the political aspect of the economic function.

The financial function of the budget has steadily become more publically prominent as growing economic intervention and new theories of financing expenditures have led to immense budget deficits. Now debt management is one of the most challenging areas for every government. Whereas in the Truman and Eisenhower administrations federal outlays generally were financed by federal revenues, following administrations, beginning with that of President Kennedy, focused more or less on a deficit policy justified and based on different budget theories, e.g. full-employment-surplus budget, in order to meet higher public expectations and to accomplish ambitious political programs. In contrast, the new Reagan administration seeks to balance the budget in 1984, despite enormous tax cuts and seeks defense expenditures. A harkening -- historically -- to a theory of a balanced budget as a measurement for possible participation and limitation of governmental activity in the economy.

As a planning instrument the budget is, a "statement about the future, which attempts to link proposed expenditures with desirable future events". It is based on numerous records of the past and its determination characterizes the government's intent rather than an accurate estimation of what the budget will achieve. Connected with these aspirations is the analytical function of providing information
about the governmental efficiency of budgetary actions and their
conformity with established goals. Thus, the budget serves as a
continuous analysis as to whether actual data are consistent with the
predicted data and whether alterations in existing programs or
additions are necessary.

Finally, as a legally binding rule the budget ties allocators
dealing with the budget, e.g. agencies, administrations, and even the
government as a whole to the stated objectives in the Budget. Without a legally organized structure it would be impossible to operate as a federal government and carry out all political responsibilities. The recognition of the budget as an management instrument led to the Bureau of the Budget's change in name to the Office of Management and Budget (OMB) in 1970.

Integration of all these functions in a single process has, over time, permitted the budget to become the major influence on politics and the state of economy. The effect on the national economy and the GNP can be deduced considering the budget's escalating size - $695.3 billion in fiscal year 1982.

The budget provides several tools for the government to guide the economy and the investment situation in order to meet desirable results. Generally speaking, each tool in the budget is part of federal spending and differs only in the way it is used and spent. Current expenses are spendings for obligations already existing through previous budgets, like interest payments for debt financing, wages for governmental employees, and costs of management and maintenance.
Transfer payments are defined as money payments to individuals, mainly social security and welfare payments.\textsuperscript{16} Finally, major capital outlays are funds aside from current expenses and transfer payments such as special new programs, economic subsidies, investment programs, interest subsidies or cheap loans. The term "outlays" includes federal expenditures for goods and services as well as net lending and grants-in-aid to the states by the government.\textsuperscript{17}

In addition to classification as to type of spending, budget allocations are categorized as either "automatic" or "discretionary" economic regulators. Automatic expenditures include social security, unemployment compensation, veterans pensions and some types of federal loans which increase and decrease according to the economic situation without any changes in law and other activity of the government.\textsuperscript{18} These programs tend to increase federal expenditures when GNP is depressed, and decrease expenditures during economic prosperity with a high GNP. Because such expenditures are largely controlled by macroeconomic factors politicians do not perceive these programs as instruments for achieving a change in economy objectives.

Discretionally federal outlays, as distinguished from automatic expenditures noted above, include such things as investment grants that are direct subsidies to investors. They may vary between industries, assets and regions and do not operate through the tax system, but are paid by the administration. They also embrace cheap loans or interest subsidies given to desirable investments below market rates, offsetting sometimes high interest rates. Similarly, the government may increase
outlays to support the growth of an industry, e.g., the building of new roads, bridges to spur construction industry. They may also be combined with procurement of work programs to reduce unemployment.

High deficits, however, make it very difficult for administrations today to create additional programs in the absence of decreases in automatic payments; a politically dangerous approach considered only in response to powerful, external interest groups. Consequently, the Reagan administration for the first time cut back social security and benefit programs -- "automatic expenditures" -- in order to finance discretionary economic stimulators and defense spendings. It will be interesting to follow during the 1980's how people accept this kind of economic recovery program.

2. The Budget Process

In dealing with budget programs which might affect foreign investments it is advantageous to have some understanding of the administrative and political budget process. It may help to determine the best time of an investment, to find out ongoing considerations of certain economic programs and subsidies and the time when they will be effective, and to know which political or private interest group might have the most powerful influence to enforce certain developments or decisions. Above all, it might give investors a chance -- depending, of course, on the size of the prospective investment -- to affect the budgetary process at various stages as far if the foreign investor can participate in the lobbying process.

The contents of the budget result from a long, complex process during which the executive, legislature, individuals, and other groups
tender numerous, conflicting proposals and then normally negotiate a set of compromises that collectively are the budget. During the fiscal year, however, it is constantly being amended as Congress authorizes new programs to become effective during that year. While the budget and its evolution are complex, four distinct phases of the budgeting process exist: a) executive preparation and submission, b) congressional action, c) execution and control, and d) review and audit.19

Executive Preparation and Submission - Preparation and submission of the budget are incumbent on the executive branch of the government, especially the President and the Office of Management and Budget (OMB). Every year in May the OMB starts to prepare a new budget, seventeen months before its beginning. The Director, several OMB officials, and some advisors examine the current economy, its prospective development, all revenues and outlays expected and the probable expenditures by each department.20 Much of this data, in summary form, is then reviewed with the President, Treasury and Council of Economic Advisors. Subsequently, OMB sends planning figures to the departments which then compose proposed, detailed spending plans by early autumn. From then until December, OMB develops the President's final budget proposals. During this period, department figures are often amended as a result of discussions between OMB officials and the individual departments. This bilateral amendment process is essentially the same for all government agencies except the defense department. With regard to the Defense budget, the National Security Council frequently mediates differences between OMB and the Department of Defense.
An important event in this struggle between OMB and the departments is the autumn Director's review, a meeting between OMB and some other Executive officials. As a result of this meeting certain "marks" for every department are determined. All marks together amount to the overall spending of the budget proposed by the OMB "minus a small allowance for subsequent negotiations with the departments".21

While the budget process in the executive branch is best characterized as a two-way flow of decisions up from the agencies and departments and then back down from the OMB and the President,"22 the role specific agencies within the major Departments should not be underestimated. Each is a specialist in a functional area which represents its interests including its clients, normally towards the budgetary end of higher appropriations. At this specific level, nongovernment interests have substantial opportunity to affect the budgetary process. Because of the extent, these political processes of interaction between client-agency-department-OMB and, later on Congress, are important for every investor to know in order to find the "right address" to direct their own actions, e.g., where and how to gain access into the bureaucracy.

Congressional Action -- In January the President submits his budget draft to the Congress. Then hearings take place before the authorization committees of the House and the Senate, the Joint Economic Committee and other committees (usually in subcommittees). In addition, the 1974 Congressional Impoundment Control Act mandates that Congress first consider total budget spendings before looking at or
altering individual programs. Furthermore, it established the fiscal year as October 1 - September 30, provided a budget schedule for Congress and established a Congressional Budget Office to provide Congress with economic information to facilitate their decision making in the budget process. In summary, Congress does not spend money but grants spending authority which the President approves or disapproves. Subsequently, the Congressional appropriations committees decide over appropriations bills "with the amounts authorized, and again the bills must go through both houses and be signed by the President".23 This total process is summarized below:

Congressional Budget Timetable

<table>
<thead>
<tr>
<th>Deadline</th>
<th>Action to be completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 10</td>
<td>President submits current services budget</td>
</tr>
<tr>
<td>15th day after Congress convenes</td>
<td>President submits his budget</td>
</tr>
<tr>
<td>March 15</td>
<td>Committees submit reports to budget committees</td>
</tr>
<tr>
<td>April 1</td>
<td>Congressional Budget Office submits report to budget committees</td>
</tr>
<tr>
<td>April 15</td>
<td>Budget committees report first concurrent resolution on the budget to their Houses</td>
</tr>
</tbody>
</table>
If one compares the President's proposed budget and the budget Congress creates through appropriations bills, large differences often exist in the amounts and the several subjects. Further, numerous "backdoor" federal outlays are approved by the congress in a fiscal year that precedes actual expenditures. These include previously promised payments by bills, like social security, unemployment payments, and veteran pensions. Such "automatic" spendings elude the rigorous review of the annual budget cycle and are a major target for limitation by the Reagan administration.

Budget Implementation -- The approved budget is the financial basis for government agencies operation during the fiscal year.24 The Treasury is obligated to obtain sufficient funds available to fulfill

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
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<tbody>
<tr>
<td>May 15</td>
<td>Committees report bills authorizing new budget authority</td>
</tr>
<tr>
<td>7th day after Labor Day</td>
<td>Congress completes action on bills providing budget authority</td>
</tr>
<tr>
<td>September 15</td>
<td>Congress completes actions on second required concurrent resolution on the budget</td>
</tr>
<tr>
<td>September 25</td>
<td>Congress completes action reconciliation process implementing second concurrent resolution</td>
</tr>
<tr>
<td>October 1</td>
<td>Fiscal year begins</td>
</tr>
</tbody>
</table>
the expenditure programs set up by the congress, although, the
President may request Congress for enacting additional budget authority
or to withhold already appropriated funds. Other agencies and
departments undertake actions and make payments authorized by Congress,
while The General Accounting Office (GAO) audits such actions. GAO
also controls the accounting system of agencies and departments and
ensures that all funds are reported and disclosed.25

3. The Types of Budgets

The budget's pervasive impact on the federal economy and visa
versa imply a need for measures the economic impacts of federal budget
policy - outlays, programs, etc. If expenditures and receipts were
treated without considering their overall impact, the outcome, e.g.
unemployment or serious inflation, could be disastrous. The budget and
its programs are based on past economic data and prospective
developments. Thus, dictated spendings, prodent when authorized could
be ineffective because anticipated conditions did not materialize.
Obviously, additions and changes are required; necessity separates
impact considerations of each component of the policy action planned
and their reintegration in order to reach an overall statement about
its aggregate effect.

Over time several budget concepts have been developed to: 1)
measure the economic impact of the budget and the "size" of the
government, 2) specify the financing needs of the government, 3)
enforce fiscal responsibility and 4) serve as a managerial tool for
programs by the Executive and Congress.26 Each, however, incorporates
a different emphasis of each objective.
The Unified Budget the traditional form since fiscal year 1969, was propped initially by the President. It was developed further "through oral testimony by the Director of the OMB and the Secretary of Treasury" before the various committees before Congressional acceptance. This budget combines all receipts and outlays for federal funds and trust funds and deducts the various interfund transactions that occur between them before arriving at the totals.28 The difference between this budget and a "multified" budget is that, the "unified" budget deals with total receipts and outlays and not with several different sub-budgets. Receipts are counted when the cash is collected and most expenditures are counted when checks are issued (an exemption is made by interest, it is reported when it accrues).29

The National Income Account Budget (NIA), in contrast, counts receipts when they accrue (it does not include personal taxes which are not withheld). Expenditures are recorded in three different ways: (1) on an accrual basis for construction and investment outlays, (2) for other goods purchased on a delivery basis, and (3) on a check issued basis for grants-in-aid, subsidies, and transfer payments. Also, while the unified budget includes net lending as expenditures, the NIA does not, because net lending is regarded a mere transaction rather than an expenditure for goods and services.

The NIA budget has two accounts, one represents market value of goods and services produced, providing for several classifications of expenditures, federal, state, and local government purchases and net exports resulting in the total Gross National Product (GNP), the other
presents different types of income (e.g. corporate profits, interests). In essence the "NIA" budget contains more detailed information than the Unified Budget which makes it easier to determine productive activity associate fiscal policy impacts. However, it should be noted that both types of budgets current accounts, i.e. current transactions. In contrast, many European countries place emphasis on "capitol budgets" that are especially concerned with capital transactions exclusively made for investment purposes. The intention of a current account budget is to finance outlays of an investment type by borrowing and to finance other outlays by current transaction.3

The Full-Employment-Surplus Budget emphasizes economic stabilizing functions by estimating receipts, outlays, and surplus or deficit that would occur if the economy was continually operating at full capacity (full capacity is defined as a 4% unemployment rate for the civilian labor force).31 By using modelling techniques budget totals are insulated from the effects of changes in the level of the economic activity. Simply speaking, one can define the full-employment budget as the difference between government outlays and tax receipts at a full-employment stage."32

The Planning, Programming, Budgetary System" and "Zero-base Budgeting" are budget concepts designed primarily to foster information and management functions associated with budget formulation rather than depict financial conditions now and in the future. The PPBS injects "needed efficiency into the decision making process in any organization, private or public")3 It is the result of a tendency to
a more planned orientation of the entire budget process. PPBS tries to combine all budgetary functions and to meet the increasing requirements of the budget in shaping economic policy. New technologies foster comprehensive information and analytical programming and planning capabilities. The program budgeting avoids the traditional "line-item" budgeting and uses instead a "presentation of program packages or end products (e.g. public health)". The PPBS integrates for the first time long-range planning and programming of specific activities with annual budgeting, making use of the program budget structure and of various qualitative techniques in the evaluation of proposals. System analysis and cost-benefit techniques are employed, with qualification of costs and benefits to aid in the selection of the tax alternatives.

A similar budgeting approach was presented by President Carter for fiscal year 1979, the so called "zero-base budgeting". This reform provides for systematic consideration of all programs and activities in conjunction with the formulation of budget requests and program planning. President Carter believed that ZBB fostered "broadly expanding management participation and training in the planning, budgeting and decision making process."

Though it is not the intention here to evaluate each budget concept and to determine which might serve best for a successful fiscal policy, some conclusions are obvious. Simple deficit or surplus approaches are sufficient indicators of fiscal policy impacts, especially if one is interested in a particular area like the
development of foreign investments in the United States. The investor needs to secure information located in the budget, how his investment decisions will be influenced by fiscal decisions and what the intentions of the government are in respect to foreign investments. This would contribute significantly in long-range investment planning. Budget forms with detailed information have obvious advantages. The decision as to which budget concept might serve best for this purpose, however, remains an debatable. While all mentioned budget formulations departing from current practice seek to stimulate a rational, economically oriented decision making process, each is advocated mainly to support and enforce political programs. Consequently, traditional budgeting has survived despite justified criticism about its incremental and fragmentary character.

III. TAX POLICY

A. Tasks, Purposes & Principles

Obviously, taxes accomodate the critical function of revenue collection, which many argue should be its only mission. This single mission, they argue, woud simplify the tax system, lower marginal rates, and abolish tax disincentives that burden the economic efficiency. In almost every country, however, the tax system is also an instrument for social and economic goals.
Transfer payments, i.e., inherent in many tax provisions benefits and unemployment compensation in budget, balance income differences and consequently are scrutinized by Congress.41 Traditionally, tax burdens are shifted from rich to poor. Tax provisions also promoted the accumulation of property by middle income taxpayers or facilitate the aged.

In addition, the Economic Recovery Tax Act of 1981 aspires to influence the economy as a whole rather than a promotion of specific segments, and thus accelerate the economy.42 For example, the personal income cuts implemented by President Reagan seek to stimulate aggregate demand by encouraging savings and investment, and subsequently increasing federal revenues that flow from the production associated with investment.

The tax system is also employed for economic stabilization because government expenditures are delayed by the authorization and appropriation process. While tax increases or reductions are implemented immediately after Congress has passed the tax bills.43 The tax system has theoretical advantages as a macroeconomic policy tool. However, politicians' sensitivity to tax changes often frustrates agreement whom will receive the reliefs and burdens of tax changes.44 Moreover, tax bills must first clear the House Ways and Means Committee, one of the busiest committees in Congress, and then are subject to lengthy diverse testimony,45 which often are irrelevant to fiscal policy.46 For example, President Johnson's tax surcharge proposal took two years to enact. In contrast, President Reagan's tax
cuts were promptly enacted due to a relatively favorable political climate in both houses, thus encouraging use of the tax system as a macroeconomic tool.

While tax policy has enjoyed erradicatic application in the macroeconomic environment, it has been used consistently to favor or discourage specific economic activities such as the housing sector (deductions for mortgage interest and property taxes) and in the field of technological innovation (treating research and development expenditures as deductible costs rather than capital items). In addition, the rate of investments and savings has been a focus of tax policy because of its prompt impact on the level and timing of investment expenditures. In this context, the tax treatment of foreign investment has been a special point of focus due to direct impacts on capital inflows and reinvestment of earnings therefrom and consequential stimulus to economic growth, high employment, and high standard of living. While escalating reliance on foreign investment has prompted rhetoric about to foreign influence, compared to United States assets in foreign countries, foreign investment activity in the United States is low.

Further, although tax investment incentives depress revenue in the short-run, they normally have substantial, long-term economic rewards.

A correlary to the stimulus effects of tax investment incentives is that federal taxation can quickly restrict, initially or unintentinally, productivity investments. Often public presures for increased taxes do not seek curtailed investments, but are linked to
financing higher budget expenditures. Thus, if productivity investments funded by domestic and foreign savings are needed to support national aspirations, expansion of federal outlays must be curtailed. The fiscal year 1982 budget was driven by this realization, but not with perfect consistency due to increases in defense spendings. Moreover, tax reductions were not focused on specific industrial developments and investments (except some depreciation and investment credit rules) to achieve microeconomic stimulation. They sought general relief which creates uncertainty as to increased, longterm revenues. In contrast, tax incentives for specific kinds of investments enhance predictability of economic impacts. This later microeconomic management is to be preferred until the predictability of more macroeconomic management through tax policy is high. The extraordinary budget deficits of 1983 and 1984 attest to the wisdom of preference for microeconomic agendas for tax policy.
demand. Tax incentives or disincentives help in manipulating the flow of foreign capital toward these diverse objectives, provided they are compatible with the evolution of the entire economy. While, e.g. tax incentives for domestic investments involves merely transfers between the treasury and the investor, tax reliefs granted to foreign investors reduce the whole country's share in profits earned by foreign capital.51

Incentives, ideally regulate foreign capital inflows to bolster the domestic economy as well as equalize the capital outflows by indirectly increasing domestic production. In essence, tax incentives have marginal utility if they merely encourage foreigners to capitalize on U.S. production advantages that do not stimulate domestic resources at the same time. Consequenty, tax incentives that encouraging reinvestment and permanent operation and discouraging short-term investment are to be preferred.52

Tax regulations, which involve federal budget outlays and have implications on foreign investments, can be classified into two categories: (a) those which adjust automatically to economic changes, and (b) those which may be employed at government discretion. Both categories affect the aggregate demand levels of the fiscal system, but play different roles. As a whole, the tax system pursues economic stabilization through automatic tax adjustments that temper the effect of changes in GNP. For example, the federal corporation and individual income taxes reduce federal revenue when the gross national income (GNP) declines and draw in more federal revenues and restrain corporate
and private income when the national income rises. Of course, foreign investors are generally subject to corporate or private income tax depending on the source of income, whether they are residents or non-residents aliens, or whether they receive investment or business income.

More important than such automatic stabilizers, are discretionary tax policies where almost every fiscal action involving taxes today is made in this area. Such discretionary action occurs when Congress increases or reduces tax rates, or imposes new or abolishes already established taxes by changing tax laws. The congressional power for economic intervention hereby is almost unlimited. As a result, a number of tax regulations affecting foreign investors have been promulgated over the years. They are dealing with foreign income, like the Revenue Act of 1962 or the Foreign Investors Tax Act (FITA) of 1966.

The latter act discouraged foreigners from using the USA as a tax haven, while encouraging investments in the U.S. by liberalizing the treatment of foreign investments.

The reason such fiscal actions are taken and the implications of such actions are summarized below.

The most important task of taxes on foreign investments -- like those on domestic ones -- is revenue collection. The share of foreign business and investment at the U.S. market is comparatively high and it is impossible to waive taxation at all, especially in the corporation income sector representing the most significant source of foreign
income. Foreign investors are an integral part of the entire social and economic life; they produce goods and services and/or hold property and must therefore contribute to the federal revenues. In deference to the importance of the individual, however, distinctions are made concerning income received from and taxed. Additional distinctions are made to achieve "international equity", the determination of how the tax pie is to be divided between the countries.55

Once basic tax equities are established, fiscal policies must determine whether taxes paid to other countries are deductible from U.S. income to moderate tax burdens of U.S. taxes or whether the foreign investors income should be treated in the same way as applies to income received by U.S. citizens. Furthermore, they must prevent economic insufficiency, the misallocation of resources, or the creation of tax havens in the international investment situation.56

Apart from revenue collection, parts of the tax system are often designed to further structural (regional and sectoral) policy by giving incentives for foreign investments in specific areas. Here state tax programs are most obvious, but federal regulations are used extensively to manipulate overall development with tax incentives.57

Conversely, when the public fears excessive acquisition of certain parts of domestic industries or real estate by foreign investors tax policies are deployed to control and limit the influx of foreign capital through investments is restrained. Such restraints may be in the form of reporting requirements concerning foreign acquisition of agricultural land or real estate or of taxes imposed to control the level of foreign investment activity.
With these governmental intentions of discretionary tax policy in mind, it is now appropriate to review the general expectations foreigners possess when investing in the United States, in order to assess the effects of taxation on investments.

The most frequent reason for their investments are: to expand the capacity of production because the existing capacities are not sufficient for the expected sales; to achieve a net rate of return; and to spend available funds, such as after-tax profits or depreciation change.58

Investors considering investments based on the first reason, can only be encouraged or discouraged by fiscal changes in aggregate demand and sales, whereas a profit oriented taxation will have no influence on the decision making process, instead affecting investors of the second class, because taxes reduce the net return. In order to finance these investment goals the use of internal funds are preferred to debt financing by most investors. In essence, taxes may not only be applied to affect the profitability of investments, but also to influence the cash flow.59

C. Summary Analysis of Indirect Tax Expenditure Affecting Foreign Investments

Outlined below are the most traditional discretionary tax instruments used by the U.S. government to implement its national investment policies. Tax expenditures normally deplete the federal
treasury as they provide direct payments by the federal government to the taxpayer. An alternative to direct expenditures through the federal budget is to give the capital user access to additional funds through tax deferral policies without transferring them from the governmental to the private sector. While such relief of normal tax burdens "costs the government money" it can increase federal revenues in the long run. The term tax expenditure is used for several provisions providing for tax reliefs in any of the following ways: (a) deferrals of tax, like the accelerated depreciation, (b) special credits, e.g., investment credit, (c) special deductions, exemptions or exclusions, or (d) preferential rates for certain purposes.

1. Accelerated depreciation

Accelerated depreciation is any method to reduce taxes in the first year of use of a particular item of capital equipment. Generally, it is understood as an additional depreciation above the normal depreciation or a substitution of the normal depreciation. It permits the taxpayer to write down that the "business assets concerned in advance of writing-down allowances that represent true economic depreciation (or capital consumption) based on normal wear and tear and other economic causes such as technical obsolescence", mostly through a declining-balance or shorter lives method.

The "declining-balance method" allows the investor to write down each year the percentage of the balance outstanding, whereas the "shorter-lives" method reduces the normal life time in which a capital equipment will be written down. It does not, of course, diminish the total amount of taxes which are to be paid by the investor, but it shifts the tax burden from earlier to later years.
Changes on depreciation rules have implications on the after-tax return as well as on the availability of internal funds, which may stimulate and support or discourage investments. Different accelerated depreciations may exist for specific industries or certain assets/equipments, although they may vary in the time of commencement of the depreciation or may be limited to a certain locality. Those various distinctions have to be considered very carefully by the prospective investor.

The accelerated depreciation and its effects on the tax liability and investment inducement depend, however, on the purpose for which the tax relief is used. If the depreciation rules are not solely applied to taxation in the first place, but also for accounting purposes, and assuming a stability in prices and costs, net income and the rate of return on specific investments will be reduced, although a further income in cash flow will be achieved. An important factor here is how the depreciation rate is based, whether on original costs or replacement costs. The accelerated depreciation may encourage investments, even if it is used for book purposes, when the continuing use of the full depreciated asset is more expensive than its replacement.

During the depreciation time price increases for the acquisition of new equipment caused by inflation must be equalized or even be exceeded by savings earned through accelerated depreciation, otherwise the accelerated deferral does not stand for an inducement to acquire new equipment.
Another argument leading in the same direction can be made if the accelerated depreciation is employed only to set costs of production for specific products and their prices depend on that, the intended investment incentive effects can hardly be gained.

Furthermore, the accelerated depreciation has to be measured and evaluated against the whole background of the tax system in order to determine whether it represents an incentive or not. The depreciation reduces -- as do other tax reliefs -- the general tax burden, but can hardly be considered an incentive, if the entire tax liability is incomparably high and the accelerated depreciation is just a partial offset of an overtaxation. Countries having no tax incentives at all for foreign investors but instead lower taxes in general might be even more attractive.

Every investor should know, therefore, whether the offered tax reliefs are incentives or discouragements in the absolute sense. For example, the Accelerated Cost Recovery System (ACRS) simplifies depreciation schedules and favors above all large industries, who, by having depreciation lives shortened for their equipment, ease their corporate tax burden. The depreciation lives remained, however, almost unchanged for small investments and the write-off possibilities benefit only investors already making investments but not those who do not have enough funds to buy new plant or equipment.
In addition, small businesses which are already in the lowest corporate tax class will not have the same advantage and investment incentive as highly taxed firms do, and the decrease of the corporate tax will further diminish eventual tax gains through depreciation for small investors. Thus, the accelerated depreciation, though theoretically an investment incentive, will not improve the situation for every investor.\textsuperscript{66}

Even more important for the investor can be the efficiency of the accelerated depreciation in regards to the planned investment. As already mentioned earlier, several reasons for a foreign investment activity might exist. Because accelerated depreciations are fiscal instruments to increase internal funds of investors and cannot be regarded as a stimulating factor to raise aggregate demand and sales in general, investors having enough funds but looking for a possible expansion of their capacities might not be attracted by depreciation rules in first place. Especially in a recession investments might be retained until the economic outlook seems to be more successful for the prospective investment.

2. Investment Credits

Investment Credits are another "indirect tax expenditure" which influences investment activity. In contrast to accelerated depreciation the investment credit is a saving in taxes in absolute terms rather than a postponement of liability and applies to all investors in the same way regardless of their individual tax rate.\textsuperscript{67} It's an offset of income from tax it increases the net rate of return or reduces the costs of an investment. Equally important, it divides the entire savings more equitably among "high rate" and "low rate" investors.
From the fiscal standpoint the investment credit is advantageous because: it cannot be used for accounting purposes in order to reduce book income instead of inducing new investments. However, this instrument is not freed from misuse. If the tax reduction, in essence, diminishes costs of equipment, lowers invested capital base or rates (e.g. in the utility industry) the fiscal intention to expand investment activity fails and no increase in rate of return or internal cash flow will be achieved.68

As it turns out, both tax tools cannot guarantee that an intended increase in the level of new investments will take place, but they are highly efficient if they are used correctly. Comparing the effectiveness of both instruments the investment credit seems to be more successful than the faster depreciation, because the investor's net return is higher, a possible misuse is limited and it can be applied to non-depreciable assets. In essence, it is today widely advocated to prefer the investment credit as a fiscal tool to ensure more or less positive investment effects. Especially its simplicity and flexibility provide a good prerequisite to be used for changes in conjunctural policy.69 This is true as long as short-lived assets are concerned. Taking a longer view a faster depreciation may be more favorable, because fiscal revenues may later regain losses made in the first years depending on the capital stock.70 The Reagan administration has chosen to rely mostly on new depreciation rules favoring the big industry.

3. Research and Development Expenditures

Research and development expenditures for technical improvements may reduce or even exempt capital gains from taxation. Especially in
the energy sector investors may be guaranteed expense possibilities for exploration costs and a percentage of depletion allowances.

International tax agreements (such as those between the United States and the Federal Republic of Germany) may exempt foreign investors from a double tax liability in the United States and their home country, which increases ultimately their competitiveness with domestic investors.

4. Preferential Tax Rates

Preferential tax rates may be provided to encourage specific investments. The advantage for the investor consists in a reduced liability of tax payments, because lower rates are applied to all or part of the taxpayer's income. This kind of incentive is highly successful in promoting investment patterns in non-favorable localities and less profitable but economically necessary business, such as agriculture.

5. Tax Reductions

Tax reductions are often used to markedly shift the investment climate. For example, a high corporation income tax rate reduces net rate of return and internal funds necessary for new investments. Despite this direct relationship between income tax rate changes and investment income, tax reductions also stimulate uncertainties and possess significant disadvantages. On one hand it is said that income taxes are usually reflected in prices. The consequence then may be that, tax rate variations do not have the desired incentive effect, because the availability of funds does not vary. On the other hand, in
comparison to faster depreciation and investment credit, rate reductions have to be given to profits of all investments and no distinction can be made between old and new. Whatever the reason for a reduction in tax rates may be the economic significance, however, lies in new investments and their profitability.?1 Thus, rate reductions should be considered as a second priority in deciding which tax incentive serves best for an investment stimulation in private businesses. This might be the reason, why the tax laws enacted in the early 1980's provide only for small business up to $50,000 taxable income a corporate "tax rate reduction of 1% in 1982 and 1% in 1983.72

6. Loss Carry-back and Carry-forwards

Carry-back and carry-forward provisions allow investors to set losses against the first profits, mainly limited to some years, reducing the amount to be taxed. Whether this possibility has the economic effects of an incentive, again is to be determined by looking at the "normal tax system". As far as it is a part of it, no stimulation will be created.

7. Tax Shelters

Tax shelters promote special investments by lowering tax burdens in certain areas. Shelters, usually achieved by forming special companies, are regarded as benefits for taxpayers with high taxable income. However, if the shelter provisions are accompanied with a reduction e.g. in marginal tax rates of personal income, like in the 1981 tax legislation, it can discourage investors in using this kind of tax relief, because the profits are less than before.
In sum, while the tendency and ability of the above tax related tools to influence particular investment activities may be characterized, definite results cannot be described without accurate knowledge on how the government will apply them. Unfortunately, the foreign investor cannot readily judge the real intentions behind the establishment of one or the other tax instrument since almost every government claims to promote investments through incentives and will never admit that some regulations may discourage the level of activity.

D. Fiscal Policy Impacts on Foreign Investments in General

Changes in federal fiscal policy as an answer to conjunctural or social needs must always be viewed against the background of several implied constraints which have enormous impacts on their effectiveness. First since half of all governmental expenditures are made by state and local government agencies, federal government influences are limited. Secondly, whereas the federal government may have the power to take part in this decision making process in granting federal funds to the states only for certain purposes, fiscal policy initiatives can easily be overshadowed by the enormous uncontrollability of the federal budget. Of the approximately $695.3 billion budget for the FY 1981 around $530 billion or almost 77% of the budget outlays are "uncontrollable" in the budgetary process.73 Those outlays are relatively uncontrollable by means of law because increases or decreases require changes in existing law. Permanent appropriations
for federal and trust funds -- like social security trust fund
belong to this category as well as contracts and other obligations
which are authorized and appropriated in earlier years whose actual
expenditures, however, are made much later. Furthermore, entitlement
programs -- veterans payments and welfare payments -- and "back-door"
spending techniques" are excluding Congress and appropriations
committees from reconsidering those outlays each year. It is even
worse, if spending programs are taken out of the budget completely,
e.g. the Rural Telephone Bank in 1973 and for some years the Export
Import Bank, or if off-budget agencies are instituted.

The part of uncontrollable federal expenditures in relation to the
total budget has become more and more significant over the last fifteen
years. Whereas the total budget has expanded by more than fivefold,
the uncontrollable portion has increased over tenfold. Moreover,
"controllable" budget fiscal variations are difficult to enact because
of policy matters. Once governmental expenditures or tax preferences
for investments are initiated, their perpetuation become vested rights
in the least, even if economic conditions require their abolition
or the goals for which they were intended are achieved. Investors
relying on reliefs once given to them may find themselves in bad
economic situations if these preferences are eliminated. People may
lose jobs or more significantly small businesses may get into financial
problems or even end up in bankruptcy. Interest groups will do their
best to prevent such developments. These issues -- which are mainly
economically oriented and should be considered as such -- become
suddenly highly political.
Regardless of some accounting techniques which look like budget cuts, for instance, and deferrals of payments, real changes of federal expenditures and tax preferences are hard to undertake. Above mentioned aspects are illustrating the narrow path governments can go to steer the economy. The lack of flexibility in budget policy decisions, particularly in the short-run, restrains their effectiveness in the investment setting. Increases in federal spendings for investment programs and subsidies in economic recessions are easier to execute than cuts in times of economic prosperity.

The use of tax policy might be preferred, therefore, though it possesses similar disadvantages. But from a technical standpoint variations in taxes have some, albeit artificial, advantages. Additional tax shelters or stimulations do not influence the momentary budget deficit and are easier to enforce in times of a growing sensitivity in the public about high budget deficits. This is an important reason why fiscal policy changes initiated to influence the economy and the investment activity mostly enter through the tax system.

A second reason for heavy dependence upon the tax system is that while tax policy changes generally take a long time to be passed by Congress, they go into immediate effect once they are enacted. Spending programs and budget cuts to a certain extent may find an easier way through Congress, although the lag between their passage and their effect on investment is considerable. Agencies which are responsible for adjudication and application of e.g. investment payments have to be determined and rules governing these processes need to be enacted.
These fiscal policy lags -- which are greater than in monetary policy -- are crucial points for every prospective investor, because they determine the ultimate economic effects of each program. An investor attracted by incentives at the moment of their announcement may have lost his interest at the time they go into effect because of changes in the economic situation in his home country or when he finds out how many bureaucratic steps he has to climb up. An improved and more coordinated procedure in Congress would help to overcome those problems and would minimize time lags as well as fragmental decision making. 

The government's difficult task is to avoid such results. It requires an exact prediction of the economic development in the near future in order to make decisions in economic policy at the right time and to guide the level of investment activity so that investments are undertaken when they are needed most. The necessity of gathering exact economic data, the recognition of an economic event, and the time lag until fiscal actions are decided pose many challenges for governments today. Unfortunately, exact economic data are often not available on a timely basis or are not disclosed because they contain facts which might discredit the government's present economic policy.

These are factors making economic forecasting for the private and public sector very difficult if not impossible and increase legislation passage-effect lags in fiscal policy. Though the precision of data has improved in the past they are still behind the actual conditions. Initial predictions always have to be corrected later on. Politicians,
therefore, have to adjust or change their fiscal policy actions according to new data. The Reagan administration is facing this problem at the moment and tries to react to the "new" economic events by further fiscal actions. This explains the fragmentary character of fiscal policy, which does not favor investment decisions.

Some good efforts to overcome these difficulties have been made by the Congressional Budget Office (CBO), providing analytical data for the Congress. It has improved the quality and quantity of budgeting information and the estimates of costs of budget alternatives. More focus on long-term economic goals through budget policy and resource allocation, and on the formulation of stable tax policy which is not subject to alteration to meet short-term economic objectives, would materially enhance the overall investment climate. Foreign investors could rely more on economic policy and their investment decisions as well as the time when they will be made and would not be oriented to short-term fiscal policy. Now, however, investors often delay investment decisions because they expect changes in fiscal policy. An increase of the investment activity after a favorable change is therefore often an artificial result.

One of the most important aspects in the investment decision making process of a foreigner, however, is the stability of a country's political and economic affairs. A fiscal policy offering copious incentives for foreign investors will have almost no success in attracting investors if the political situation in the country is characterized by too many economic political risks for the investor.
This political aspect in the foreign investment decision illuminates a limit of efficiency of fiscal policy. A political attitude of a government towards the support of private business might be an even greater stimulation than some favorable depreciation rules. The belief in private enterprises and its support by politicians and their decisions seems to be the best requisite for an increase in investments. With its shift of emphasis from the public to the private sector and its general support of private entrepreneurs the Reagan administration can be cited in this particular point as a good example.

IV. FISCAL POLICY IMPACTS UPON [DIFFERENT TYPES OF] INDUSTRY SECTORS

A. Sector Classification

Foreign direct investments are commonly understood as the direct or indirect ownership by one or more foreign persons of 10% or more of the voting securities of an incorporated business or the equivalent of an unincorporated business. A foreign person includes hereby any individual, branch, partnership, association, trust, corporation, government, or government enterprise resident outside the United States. The term "foreign direct investment" includes U.S. firms directly owned by a foreign stockholder as well as those indirectly owned through another foreign-owned U.S. company.
Such investments are concentrated in the Northeast, West Coast, or the South East (IISunbelt-States). Foreign investors enter the U.S. market in several ways: through the acquisition of all or part of an U.S. company, through joint ventures with U.S. companies, or by the establishment of new plants. Recent surveys show that mergers and acquisitions are the most prevalent form of starting business in the United States. Multinational corporations from Europe, Canada, and Japan are the dominant investors, but the number of small and medium-sized firms has increased tremendously. Foreign owned companies of all sizes are found in almost every major industrial sector of the U.S. economy.

Those sections of greatest interest to foreign investments now and prospectively, are in the Standard Industry Code (SIC) areas of:

1. Agriculture, Forestry, and Fishery
2. Mining (coal, gas, oil extraction)
3. Construction
4. Manufacturing
5. Trade
6. Finance
7. Insurance
8. Real Estate
9. Others

This classification is suitable for examining fiscal policy decisions and their impacts on different types of industries since it directly distinguishes between capital and labor intensive industries,
as well as indirectly differentiates among large multinational firms which dominate particular sectors and small companies characteristic of others. The following pages discuss these sectors in terms of future relationships between foreign direct investments and fiscal decisions.

B. Renewable Resource Industries

1. Agriculture

Agricultural foreign direct investments in the late 70's and early 80's have been a major economic issue. Persons, especially farmers, expressed their concern about a sell-out of prime U.S. farmland to foreigners at prices which could hardly be paid by U.S. farmers. Indeed, the investment in U.S. farmland has been one of the best investments in the last decade; particularly in the 1970s when the land value more than doubled and farm real estate was an excellent inflation hedge. In addition, the dollar depreciation and tax advantages of foreigners when they invest abroad, increased the number of foreign investors. Often good farmland -- if available -- is too expensive in their home country, e.g. Europe. Relatively low prices and the expected value increase were motives for speculative investments.

The situation, however, has changed. The concern was primarily based on the reason that, no sufficient data about foreign investment were available, except that contained in the annual reports to the U.S.
Congress by the U.S. Department of Commerce in 1976 in compliance with the Foreign Investment Study Act of 1974 and the International Investment Survey Act of 1976.\textsuperscript{86} In an attempt to remedy this, Congress passed, therefore, in 1978 the Agriculture Foreign Investment Disclosure Act, requiring reports any time a foreign person acquires or disposes of an interest on U.S. agricultural land.\textsuperscript{87}

Though the whole issue was exaggerated at that time -- the Department of Agriculture stated that it could not be possibly be more than 1\% of U.S. farmland which is owned by foreigners -- it might have increased the awareness of the situation and the government will pay more attention to it. The new reporting requirements, however, have not stopped the attractiveness of U.S. farmland investment. Compared to all foreign investments made in 1980, those in agriculture and forestry ranked third behind real estate and manufacturing, showing a substantial addition in 1979 though the total number of investments declined by almost 12\%. Whereas in 1979, 81 investments were made in agriculture and forestry, 127 foreign investors were willing to invest in this sector in 1980; an overwhelming majority were made by U.S. affiliates.\textsuperscript{88}

Despite the increase of land value earnings in the agricultural sector, many farmers have been forced to sell their property because of bad earnings in the last years due to droughts and other reasons. In the early 80s high interest rates prevented other farmers from acquiring offered land and thus foreign investors with surplus internal funds or a non U.S. institution financing had an ideal opportunity to purchase farmland.
An economically positive effect of such foreign purchases often flowed from the fact that the investor leased back the farm to the old owner and thus permitted new capital inflows to acquire new equipment that would increase net earnings.

As far as fiscal policy is concerned several instruments could influence this situation congruent with existing political goals, regardless of whether such goals favor foreign investors or not. An improvement of the internal fund and cash situation of domestic farmers by cheap loans, subsidies or special depreciation rules would strengthen their financial position and allow them to keep pace with the foreigners bidding for farmland.

Under the new tax laws in the early 1980s depreciation provisions for agricultural investments and general investment credits brought some relief, as well as some reduction in estate gift taxes and tax exemptions at the death of the owner of the farm. Whereas latter provisions will bring improvements to everyone, the depreciation rules only favor those farmers earning enough profits and who are subject to tax payments. Foreign investors, too, benefit from these fiscal policy regulations in almost the same way -- with exemptions to the gift and estate tax exemption -- which might attract an investment in U.S. agricultural land even more.

Far more important to foreign investors in the future will be the "Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)". This act provides generally a different treatment of the disposition of a "United States real property interest" after June 8, 1980. Every
disposition of real property or shares in a corporation the assets of which are substantially composed of U.S. real property will in the future result in a taxable capital gain.

Prior to the enactment of this law it was possible in many cases for a foreign investor to sell U.S. property and avoid completely U.S. tax on the capital gain realized. This new provision will have an enormous impact on foreign investors, especially on those who regarded their investment in farmland mainly as an object of speculation and were attracted by land value increases. The substantial increase of investments in agriculture and forestry might be a result of the expected enactment of the law.

The law brings more equity into the tax system by eliminating some advantages for foreign investors. However, it may be doubted how effective fiscal policy can be in dealing with foreign investments in agriculture insofar as no absolute "close-down" is intended. The goal of fiscal policy is to keep the foreign investment activity in farmland at a relative low level in light of the national interest. The tax system should be used as an instrument which benefits those foreign investors that increase employment and productivity and discourages those just holding the property but not using it in an economically productive sense. The disclosure requirements, the new tax rules and higher property taxes might lead in that direction.

Though higher taxes, increasing federal regulations, an appreciation of the dollar value and land prices may lower the activity, the
attractiveness of farmland ownership will remain. The farmland investment is a low risk investment compared to other kinds of investments which balances a lower rate of return and minimizes expectations of profits of investors. Furthermore, farmland investments often are not made for mere economic reasons. The acquisition or establishment of agricultural land in the U.S. may have other values to the foreign investor, e.g. a long-term security and diversification of personal wealth, or recreational, or political aspects. Though the land value increased over the last years farmland is still cheaper in the U.S. than in some European countries, also the percentage of available farmland is higher in the U.S. These reasons limit the effectiveness of fiscal policy in this sector and federal tax policy will not have great impact on the investment decision making process.

Only federal provisions limiting foreign investments will be effective. In some states laws are already restricting substantially the ownership of land by alien individuals and corporations, or inheritance of real estate by aliens.91

Foreign investors do not need to be afraid of such possible legislation on the federal level because the foreign farmland interest as a whole is relatively low compared to assets held by U.S. companies in other countries. A change of U.S. policy toward the restriction of foreign investment in domestic farmland may lead to similar regulations in other countries and would involve high political issues.

2. Forestry

Forestry foreign direct investments increased significantly according to 1980 statistics.92 The United States offers unique
opportunities because of almost unlimited forest resources and the world's largest single market for wood products. Three kinds of participation in U.S. timber market occur: first, the ownership and utilization of timber and timberland, the complete acquisition of processing and sale facilities here foreign investors are predominant -- and the forming of supply agreements.

Some foreign investors take part in the U.S. market by exporting forest products to their home country because they lack forest resources but use their processing technology at home; they also simply participate in the U.S. market through all stages of production. Others intend to establish business at the U.S. market before federal regulation might be initiated to preclude a growing foreign control over the forestry industry. Some existing U.S. regulations in Alaska, one of the most important forest regions, are already influencing foreign investors in preventing them from exporting raw timber. They require investors to establish or acquire U.S. companies to process timber before exporting it.

This kind of fiscal intervention can be described as a positive regulation for the domestic economy. Because renewable resources are available in such large numbers and foreign investment activity in the forest industry is not diverting significant amounts of timber from domestic use a complete exclusion of foreign investors is not necessary. However, the domestic industry will not benefit enough, if the timber is not processed in the U.S. and no operation is established. Particularly in Alaska foreign investments will be used for domestic
economic stimulation and employment possibilities. Foreign investors may be confronted in other areas in the future with similar restrictions, whereas a general limitation of investments is not likely to be expected. The acquisition or establishment of processing sites will be, of course, subject to the new agricultural disclosure provisions.

Fiscal policy changes may enter through the tax system. Special treatment of depletion or operating expenditures may favor or discourage investments as well as protection provisions against the loss of timber by fire, wind, storm etc. (casualty losses). However, like in the agricultural sector, many foreign investors will not look at preferential or favorable fiscal provisions. More important is the availability of resources that the home country lacks. Even a high tax burden making the depletion and processing very expensive may not prevent investors because their domestic industry needs the resources and it might still be cheaper to have their own access than to import the products from others.

Timberland as a speculative investment in expectation either of a timber value increase or of a possible conversion into recreational or developmental projects may not be favorable any more since the FIRPTA changed the treatment of capital gains. Another aspect is worth mentioning: the timber industry depends to a large extent on the housing sector. Fiscal policy changes in this sector will have indirect influences on the timber market. An investor is therefore well advised to look at the economic situation of the housing sector.
3. Fishery

Fishery foreign direct investment is now small terms of both numbers and impact on the national economy. Investors have concentrated their fishing activity in the northeast Pacific with establishments in Alaska. The Japanese primarily are doing business and intending with their investments to develop bottom fish harvesting and processing. Foreign nations have strengthened their harvesting efforts over the last three decades tremendously due to a less well equipped and functioning U.S. fishing industry. Today Canada and Japan are exporting significant numbers of fish to the United States. The federal government enacted promptly in 1976 the "Fishing Conservation and Management Act", a law which created a fishing conservation zone up to 200 miles and deals with foreign fishing in the zone. Though the U.S. does not claim ownership in the 200 miles zone and foreigners still have some access to the resources, it limits their fishing possibilities to a large extent and additionally the foreigner has to pay for management costs. The U.S. fishery industry first believed that the act would extend ownership of natural resources requiring fishing only by U.S. companies or individuals, because it considered it to be a "protectionist measure designed to maximize the economic benefits derived from having mostly American harvestors in the zone".

Whether the development will go in this direction is uncertain and may depend also on the ultimate impact of the Law of the Sea Conferences. Legislative action has enlarged the access to the resources for U.S. firms which led to the acquisition and establishment
of U.S. plants by foreigners to assure future access. It brought at the same time an increase of foreign direct investments in the processing sector either in U.S land-based plants or floating processing vessels.101

As in other industries the land-based investments, which will stimulate domestic economic resources, will be rewarded by fiscal policy decisions in the future. Also foreign technology transfer may result in arrangements which will favor foreign investments.102

Fiscal policy regulations in the near future will depend mainly on two facts in the fishery industry. On one hand, because of the determination of the 200 miles zone, a lot of foreign fishermen have to be replaced in order to serve the domestic market and develop bottom fishing, which requires a huge amount of capital investments in new vessels. On the other hand foreign investors can offer equipment and capital and may open connections to their markets. Thus far, long-term governmental regulations which might increase participation of foreigners in bottom fishing such as by allowing higher quotas and other actions which take the domestic and foreign situation into account may be advantageous to both sides.103

The foreign investment climate consequently will be heavily influenced by future regulations and control over fish resources. Budget and tax instruments will only have a minor impact in this sector. In the processing field foreigners as well as domestic investors will benefit from new depreciation rules and lower taxes for investment income easing some investment burdens.
C. Mining Industries

Due to a high demand of energy and non-energy mineral resources by most of the major industrialized countries which have no resources of their own, foreign direct investments in these industries are very attractive. It assures, to a certain extent, access to needed resources for the home industries and reduces dependence on trade with oil producing countries, most of which are Arab states with unstable political systems.

Federal laws governing investments in the area generally do not prevent foreigners from developing minerals on the public domain and some existing limitations are not regarded as effective barriers if the investment is made through an establishment or acquisition of U.S. company or association.104

The activities of foreign companies embraces stages from exploration and production, to refining and marketing. Foreign investments in the non-energy sector, like iron-steel, bauxite-aluminium, copper, etc. (metallic minerals) and phosphate, potash, etc. (nonmetallic minerals) are insignificant.105 In 1980, 15 investments equivalent to 1% of the total number, with $170 million outlays were made in the mining industry, standing for a substantial decline compared to those undertaken in 1979.106 A sluggish economy and less earnings reduced internal funds and high interest rates during the early 1980s made new investments financed through the U.S. capital market very expensive.107
Far more important are foreign investments in the energy sector. Of the total foreign investment position the petroleum industry accounted for 20% at year-end 1980. Here, too, a sharp decline in the number of investments and investment outlays is indicated based on similar reasons as in the non-energy sector and due to the fact that there was no counterpart to a large petroleum acquisition in 1979. Investors, mainly multinational companies, some with a long history of involvement in the U.S. market, might have also restrained their investments in anticipation of the presidential election in hopes that a change in fiscal policy will foster a more favorable investment climate.

The energy industry is a fundamental component of the national interest because its development is crucial for the future of society. High capital investments for exploration and production of oil, gas, and coal are required under all conditions and governments are willing to provide the industry and foreign investors with fiscal incentives. Extractive industries are capital intensive industries which rely on long-term investment policies, and depend on special taxing schemes that help "underwrite" risky ventures. Fiscal policy here works mainly -- besides other regulations for all industries -- through windfall profit tax rates, deductions for intangible drilling and equipment costs, depletion allowances, geological and geophysical expenditures, or exemptions from profit tax. Restrictions and taxes on imports of foreign oil and gas affects domestic energy production, too.
One other aspect, indeed, should not be forgotten: the oil and gas industry belongs to those regulated and controlled by the government in order to steer prices made in a powerful oligopolistic market. Changes in the extent of control or a deregulation resulting in price movements might have even greater effects on the investment activity than tax regulations.

The fiscal decisions under the II Economic Cost Recovery Tax Act provide enormous incentives for both major firms and small independent producers in the oil industry. The windfall profit tax rate — a tax on newly discovered oil — will be reduced in phases starting 1982, dropping the rate from 30% down to 15% in 1986.108 It may save money for new exploration ventures to discover and produce more oil.109 The tax reductions will be well received by industry as a compensatory response to the increasing income of foreign oil companies which due to higher prices of the OPEC and a gradual deregulation of crude oil prices in the U.S. since the third quarter of 1979,110 amounted to a 61% income increase in 1980.

Large scale oil companies will be allowed to offset large parts of their profits from taxation. The new depreciation rules, a 61% reduction in write-off times for oil refining and distribution equipment, and the depletion allowances of 20% in 1980, scaled to 15% by 1984, will also strengthen the cash and internal funds situation for the big corporations though the investment income tax rate reduction will lower the shelter-profits somewhat.
The small industries will not have the same advantages. Lower income reduces gains of tax relief through depreciation or allowances and the decontrol of the oil prices did not result in higher profits as it did for the larger firms. However, the so called independent producers of stripper well oil will benefit from a windfall profit tax exemption after 1982 offsetting some earlier disadvantages. It will put the independent producers in a position to keep marginally profitable oil wells in production.

Planned fiscal policy decisions in the natural gas sector are undergoing numerous considerations. The President Reagan's guest for a balanced budget and a sluggish economy with unexpected deficits call for the need of additional revenues. Though President Reagan opposed a windfall profit tax for gas he or his successor may be forced to adopt the proposal if his economic program is to succeed. The investor could gain some relief if the new taxes are combined with a decontrol of gas prices favored by the industry having a higher income in mind.

Whether such an enactment is likely to occur depends on the rate of economic recovery. Under adverse economic conditions, an administration normally digs out every plan which raises revenues. Therefore, the new tax can be expected during the 1980s, although generally the mining industry enjoys favorable fiscal policy.

D. Construction Industries

Foreigners invest in the U.S. construction industry mainly in the areas of construction engineering and construction-related manufacturing, e.g. building supplies, and equipment and cement. This is one
of numerous industries whose health is linked to the overall state of economy and the investment situation of other industries. If fiscal policy decisions favor an increase of internal funds and if the economy is not moving towards a recession, the construction industry will benefit from additional investment activity of other branches. Therefore, the most successful fiscal policy for the construction industry is one which promotes the growth of other industries in first place for which construction is a sine qua non for their expansion. Of course, the construction industry benefits as well from corporate tax reductions, depreciation, and other allowances. Some research and development incentives, such as the 25% tax credit under the early 1980s tax laws, may increase the rate of technological development in the construction industry. Multinational firms with subsidiaries in many countries might shift their entire technological research to the U.S. due to a comparably favorable fiscal policy.

Budget expenditures for the construction of public roads, bridges, building, etc. have another important influence on this branch. Excessive budget outlays to finance ambitious programs may stimulate construction investment activity. This is true to the extent that the activities and tasks are "public oriented" and are to be fulfilled by the government. As far as the additional governmental activity displaces private action no investment stimulation can be expected. In an economic recession with less private investments such budget expenditure programs are in favor of the construction industry and foreign investors -- perhaps with new technical innovations -- may participate
in this situation. Foreign investors should therefore be informed as to whether the government supports such programs.

These expenditures, on the other hand, may have a negative impact in a recession. They increase inflation. In order to prevent such a development the Federal Reserve will pursue a tight money policy with high interest rates as a result. Foreign investors with a lack of internal funds -- which are mostly small firms -- will not be able to borrow in the U.S. market and will postpone their investments unless they can get cheaper funds from a non U.S. financing institutions. The home building industry is a good example of this.

This stresses the close linkages between fiscal and monetary policy and underlines the necessary communication between them, otherwise the desired impacts will not take place. Foreign investors should therefore look at fiscal policy as a whole and not for instance at some favorable budget outlays.

E. Manufacturing Industries

Over one third of the investment position (37%) of 1980 was located in manufacturing, mainly chemical and allied products, food, machinery, and primary and fabricated metal products.116 With 203 investments and the highest outlays of $3.4 billion in 1980 it is the most attractive industrial sector for foreign investors.117 Industries with high energy needs, such as the chemical industry, enjoy lower energy costs and are subject to minor vulnerability of energy disruption in the U.S. than in Europe. Due to dollar devaluation and an increase in
production costs in many countries compared to the U.S. it became more attractive to produce in the U.S. than exporting goods to the U.S. market.

The manufacturing industry covers a broad field of industrial activities, characterized by capital or labor intensiveness and businesses whose sizes vary enormously. Foreign investors are generally not controlled by federal regulation -- except by those which apply equally to domestic firms such as antitrust laws -- in doing business in the United States, in contrast to natural resource sectors mentioned above. It seems that manufacturing is more sensitive to fiscal and monetary policy decisions than the natural resource industry because foreign investment decisions are based mainly on mere economic and profit oriented reasons. A tax policy which increases the net rate of return of the investment might be a decisive factor in the decision to invest in the home country or in the U.S.

Manufacturing firms with a high labor intensiveness, such as the transportation equipment industry, will focus on a fiscal policy favoring low labor costs. Besides a low wage level foreign investors will be attracted by tax laws offering tax credits for benefits given to their employees. The new tax laws providing a favorable treatment of savings by employees if they put them into retirement accounts and fringe benefits will not be regarded as taxable income until late in the decade. Firms will receive bigger tax credits for offering employee stock ownership, and it will be easier to withdraw funds from profit-sharing plans for their employees.
Such fiscal incentives should not be underestimated. Their impacts might result in fewer strikes and a good relationship to the unions which, in essence, may be more important than other investment prerequisites. Especially for investors starting new business in the U.S., good working conditions for employees are very important and minimize labor oriented problems. Capital incentives for new investors may be destroyed by difficulties arising between employer and employees supported by the unions. The growing power of unions and the high percentage of unionized industries, especially in Europe, is a significant factor why foreign investors invest in the U.S.

Even the general attitude of the government might have some impact. The Reagan administration's notably unyielding position in the air traffic controller strike, and its tendency against unions in general, may have brought a loss of power and popularity to the unions. The same effect may have President Reagan's political attempts to follow goals that unions have been demanding for a long time, such as a general income tax reduction.

Capital intensive industries welcome investment credits for new equipment, accelerated depreciation rules, or corporate tax reductions. Such provisions will reduce tax liability and will facilitate the raising of funds for new investments. The "Accelerated Cost Recovery Act", for example, brought tax reliefs for investments in office buildings and some type of equipment.\textsuperscript{119} Whereas industries with high taxable income are rewarded by such depreciation rules, no investment effect will occur on those capital intensive industries with huge
losses like the big automobile companies or the steel industry. Neither tax reduction nor depreciation rules will increase their internal fund situation. Regulations to "carry-forward" losses may help as well as the leasing possibilities under the new tax act. Tax credits and accelerated cost recovery allowances are allowed to be sold by companies with recent income problems to those making high profits.\textsuperscript{120} It improves the cash flow of the "poor" firms and reduces tax obligations of the "rich", which may even avoid tax payments at all by investment credit acquisitions.\textsuperscript{121}

For most capital intensive industries the recent tax provisions are a "back-door repeal" of the corporate tax.\textsuperscript{122} The corporate tax rate is a heavy burden on the economic growth of a company levied mostly for equity reasons. However, reduction or abolitionment does not have the same impacts on the investment climate than depreciation or investment credits. As mentioned earlier, the corporate tax is shifted over to product prices, shareholders, or employees. From a governmental point of view, more certainty exists as to what corporations will do with funds available from depreciation rates or investment credits than it corporate tax rates were reduced.

A difference might exist as far as small businesses are concerned. Whereas big corporations have some "shifting possibilities" small companies are highly transparent and might welcome tax reductions as a real investment incentive. But only a substantial reduction will cause some impacts. The reductions in 1982 (1\%) and 1983 (1\%) provided for small business in the early 1980s tax laws will not bring enough
savings for additional investments as they would do to big industries. The same argument can be made with the accelerated cost recovery provisions. Small companies are not able to set off enough assets for investments in order to benefit from them. In addition, the depreciation rules did not change write-off lives for small investments, such as trucks, automobiles, information and data systems, supposed to be the usual investments of small businesses. Here, investment payments or cheap loans offsetting high interest rates might be more effective. Also investment credits are to be preferred if a significant amount can be deducted. The tax act increased investment credits for vehicles from 3.3% to 6% which are considered to be a partial offset of the detriments in the depreciation rules.

As capital intensive industries with high losses, small companies will profit from the leasing provisions in the same way. Of course, it might be doubted how long the administration is willing to accept this "loophole". New equipment can now be leased from "tax shelter firms" while an acquisition due to low profits and high interest rates would be impossible for small firms. Some other legal changes would bring similar relief. Foreign investors as well as domestic investors of small sized companies are suffering heavily from bureaucratic regulations. Some are requiring firms to keep records of all kinds and to fill out forms, others are providing for special inspections particularly in the manufacturing industry. Those administrative burdens are hindering small firms especially in their flexibility, reduce profits and decelerate economic growth. Small foreign investors that
are not acquainted with such regulations and have no staff to meet the requirements might desist from investments or might face trouble later on after the investment is made. The intended deregulation and decline of governmental interference by the new administration will facilitate the daily life of small businesses.126

F. Trade Industries

Wholesale and retail trade together amount to 20% of the foreign investment position in 1980 with over $13 billions concentrated in food retailing, department and apparel stores and specialized chains.127 Though the total position in trade increased, the number of investments and investment outlays in wholesale trade declined by almost 33% whereas the number of investments in retail trade slightly increased and specialty outlays doubled in 1980. This was due to a large single acquisition that has made the retail branch more important than the wholesale branch.

The overwhelming majority of investment outlays were made by acquisitions of U.S. affiliates.128 The level of foreign investment activity in trade follows to a far greater extent the overall economic situation than in some other mentioned industries. The trade as a whole represents a type of industry which is sensitive to economic vacillations regardless of whether they tend toward recession or growth. Merchandising firms depend mainly on ordinary consumers who are making their purchase decision on a short-term oriented basis, with some exceptions for durable goods. The purchasing patterns of some
basic products aside, a sluggish economy with a decline of income and an increasing unemployment will prevent consumers from buying non-
necessity or luxury items or from replacing old but not broken goods.

Taking this into account a fiscal policy which generally strengthens the position of consumers will increase spendings or at least keep it at a certain level desired in times of economic problems. Tax rate reductions, a rise in unemployment payments or greater brackets of tax exempt income will offset funds for additional spendings and result in an increasing aggregate demand. Trade benefits most from such a fiscal policy and might in the long-run attract foreigners to invest.

As in the manufacturing industry, trade as a labor intensive industry is interested in fiscal decisions which improve working conditions for employees without shifting the financial burden to the employer. As in other branches foreign investors who establishing new stores, office buildings or shopping centers benefit from the new depreciation rules, which shorten write-off times to 15 years compared to 36 years under the old laws. Foreign retail companies will welcome such provisions because it facilitates the access to the U.S. retail market. Unlike in other industries the retail traders must normally have a location in the United States in order to compete with domestic firms and to serve the market.

Retailers for some durable goods, such as automobiles, favor low interest rates since the inadequacy of internal funds requires purchases to borrow the money. Obviously, high rates indirectly
suppress demand for large items that entail consumer credit. Though fiscal policy does not aim at interest rates in the first place -- this is done through monetary policy by the Federal Reserve Bank -- fiscal decisions influence monetary decisions indirectly. Budget cuts and incentives for savings stimulate growth in money supply by reducing governmental and private financial needs and eventually lower the rate. Such policy -- in regard to interest rates -- may in fact increase purchases and improve the investment climate in the long-run.

G. Finance Services

With a growing foreign business more and more foreign banks and financing institutes have decided to invest in the United States, especially in the last decade. They locate here for several reasons: to provide for assistance in financial matters to their home country investors holding interests in the U.S.; to take part in the large U.S. money and capital markets; to finance foreign trade, - and advise U.S. banks.130

The number of foreign investments in banking doubled between 1979-1980, whereas outlays more than halved.131 The reason is that, the foreign banking activity was limited to small size investments, without regard to some acquisitions of stock of big U.S. banks.

In recent years mostly small and local banks with no international business were concerned about the growing influence of foreign owned financial institutes on the market. Due to lending and investment operations banks can control to some extent the local economic
activity. Therefore foreign direct investments in the banking industry is a particularly sensitive matter.132

Since banks are the key to a strong and successful economy, the U.S. banking industry is intensively regulated at the state and federal levels. Thus foreign investors are confronted with a "dual system" of federal and state provisions. Differences exist between states as to whether foreign banking business is allowed at all or if their activity is limited to the state of incorporation. The International Banking Act of 1979 (IBA)133 provided for equitable treatment of foreign banks as regards their domestic competitors by abolishing some favorable and some discriminatory regulations for foreign banking activity.134

The question, of course, is how can fiscal policy have some impacts on foreign investors in that type of industry. Obviously, foreign investments and their success depends to a large extent on federal regulations and the Federal Reserve's monetary policy impacts on the attractiveness of foreign investments in banking.

Fiscal policy, however, may indirectly impact on foreign banks. First, foreign commercial banks may benefit from favorable investment incentives and economic conditions when using their funds. Banks often invest in real estate, such as office buildings and apartment complexes. Accelerated depreciation rules increase internal funds and the net rate of return, which in turn allow them to offer more and cheaper loans. Tax cuts and fiscal incentives for savings additionally improve the financing business.
Though the foreign bank's situation is guided by the Federal Reserve's determination of the discount rate and the reserve requirements with their impacts on the interest rates, fiscal policy might be a key factor to the monetary policy. A government policy which focuses on budget financing through taxes and other income rather than on debts involves a lower volume of loans. Considering today's tremendous budgets this will increase the money supply available to the private market and would lower interest rates. This is true as long as the Federal Reserve pursues a tight money policy to avoid a round of inflationary escalation. Thus far, monetary policy reacts to some extent to fiscal policy decisions.

Although the indirect influence should not be underestimated tax and budget policy exert only limited impacts on the foreign banking industry. Federal and state regulations and the monetary policy may not provide a favorable investment climate to begin with.

H. Insurance

Foreign investment activity in the insurance industry increased slightly at the end of the 1970's, to $5 billion at the yearend 1980,135 but was still insignificant. Some foreign insurance companies have been integrated into the dominant U.S. insurance market for a long time. Consequently, increases in federal regulations to protect domestic insurance companies136 are improbable.

However, unlike the banking industry, insurance is controlled primarily on the state level. Currently, there are extensive for entry
requirements for entry into a state but they are not intentional investment barriers. Most foreign insurance companies are engaged in the property and liability sector providing primarily service for investors in other industries of their home country. A fiscal policy which promotes foreign investors in every respect will have some positive impacts on insurance in the long-run. As foreign investments increase, more insurance companies will enter the market to provide service and assistance for their own clients at the foreign location. Furthermore, insurance companies themselves are always interested in good investments. With an establishment of a branch office the access to investment possibilities are much easier and fiscal incentives through budget or tax policy may result in higher net rates of return than in their home countries.

Similar to banking, insurance is more interrelated to monetary policy than other industries. High short-term rates may create liquidity problems because policy holders will switch to more attractive investments and accelerate "policy loans" with low rates. Here, too, the government's borrowing needs result indirectly in positive or negative effects.

I. Real Estate

Direct investments in real estate enjoy great popularity among foreigners. Though the foreign direct investment position in real estate is still lower than in other industries, it accounted for 4% at the yearend 1980. Half of the investments in 1980 were made in real
estate with second highest outlays of $2.7 billion. Foreign purchasing concentrates on U.S. land, residential and office buildings or shopping-centers, using very often tax havens such as the Netherlands Antillies. Generally they are looking for investments with high security and long-term appreciation either in highly recognized cities or economically growing areas, like the north-eastern cities or the IISunbelt-states. Objects with high quality and prestige are preferred over current return underlining the long-term investment planning.

Federal legislation during the last decade has sought to influence real investment activity. The International Investment Survey Act of 1976, which requires reports of real estate acquisitions by foreigners, has not been a major impediment to continued investment. However, the Foreign Investment Real Property Tax Act of 1980 may significantly reduce the attractiveness of real estate investments in areas or cities with high economic development and rising property value. Since it is equity oriented and puts the foreign investor in the same position as his domestic competitors. As mentioned earlier, capital gains in real property cannot generally be avoided any more under the new laws. Some tax treaties between the U.S. and other countries may still provide exceptions. Though real estate investments are not made for speculative reasons in the first place, property value increase is one major factor in the investment decision making process. Despite the differing motivations in making long-term and speculative purchases, value increase remains a factor in making long-term purchases.
Conversely, foreign investors benefitted from the new tax provisions concerning office buildings, shopping centers and apartment buildings which shortening depreciation lives to 15 years; giving tax reliefs between 58% and 63% compared to the old laws.\textsuperscript{142} Thus, companies will consider buying office space in the future instead of renting it. Even though they preferred fixed monthly expenses rather than long term debt.\textsuperscript{143} Due to favorable depreciation and new \textsuperscript{II}recapture\textsuperscript{II} rules which allows investors to keep depreciation advantages even if the office is sold before the mortgage is paid, foreign companies are likely to recognize substantial benefits from their real estate investments. Residential investments, on the other hand, brave declining attractiveness as tax shelters for foreigners because taxable investment income was less heavily taxed in 1982 and the level of required income to use these shelters had scheduled rises until 1984.\textsuperscript{144}

The real estate industry -- like the retail business of automobiles -- depends mainly on interest rates for loans and mortgages. Foreign investors dependent upon financing through U.S. institutes will curtail their investments if interest rates are high as one can see at the moment -- though fiscal decisions offer great incentives. This stands for a typical example of an offset of fiscal policy by monetary policy.

However, the impacts are not that significant for foreigners as for domestic investors. U.S. sources financed in 1980 only one third of the foreign investments and only a small percentage of it were
U.S. cannot but be a hindrance therefore to foreign investors. On the contrary, one is inclined to say that it makes foreign investments in real estate even more attractive because with high interest rates sales are down, which lowers prices or at least keeps them at a certain level. Therefore, a fiscal policy favoring debt management, which results in high interest rates if the Federal Reserve follows an anti-inflationary course, may have in that respect some positive impacts on foreign real estate investors.

As in other industries, fiscal policy impacts are limited because investors in real estate generally are more concerned about diversification of their property, security, and political stability. Today's fragmentary and short-term oriented fiscal policy can only be to some extent a possible basis for foreign investment decisions.

J. Others

Foreign investor control broadcasting companies and communications common carriers is excluded by federal licensing laws. The same is true for air transportation, which is limited to domestically registered aircrafts although exemptions may exist where the foreign investment and service is in the public interest. Conversely federal rail transportation law regulates only the industry and does not restrict participation of aliens. Since foreign investment is so limited, the impact of fiscal policy is minuscule.
V. CONCLUSION

Evaluation of how fiscal policies will affect foreign investment in major sectors of the U.S. economy is exceedingly important to U.S. policy makers and foreign investors alike. However, such evaluating is made difficult by many factors. First, present fiscal policy decisions depend to a large extent on political facts and structures reducing the efficiency of fiscal instruments. On one hand, huge budget deficits and an increasing amount of non-variable expenditures, caused by "automatic tools" or "back-door spending", limit the flexibility of the economic management of today's government. On the other hand, a lack of sufficient economic data and different influences and powers of interest groups result in fragmentary fiscal decisions. Foreign investors, usually with long-planning interests, can not rely on such short-term oriented policy. More continuity based on long-term decisions would have greater impacts. Interrelated with these political shortcomings are different time-lags between the planning, the decision, and the effectiveness stage. Fiscal instruments may have positive impacts at the time of their planning stage but may produce results at the time of their effectiveness opposite to those desired.

Second, foreigner investment motivations are often not closely related to financial areas which fiscal policy decisions seek to change. Tax incentives may improve the investment situation, but foreigners often don't invest for reasons of favorable taxes. Energy needs and business opportunities in the huge U.S. market may be more important and personal, non-economically oriented reasons may play a
decisive role in the foreign investment decision making. It depends, of course, on the type of industry.

Third, to some extent foreign investments, especially in sensitive industries, are regulated or controlled in certain ways by federal or state law. These laws have far greater impacts than fiscal decisions. Regulations may totally preclude alien ownership; require disclosure of acquisitions; or regulate daily business. Federal legislation may also exist which is oriented to both domestic and foreign investments and which may be regarded as an incentive or barrier, e.g. environmental control provisions that may be more stringent in comparison to those in the home country.

Fourth, one of the greatest -- if not the greatest -- limitation on the possible influence of fiscal policy is its counterpart, monetary policy. Though monetary aspects are not stressed here for reasons of scope, their impacts on the investment climate should not be underestimated. As seen above, some industries depend on the Federal Reserve Bank's decisions. The significance and the offsetting possibility of fiscal investment stimulations by monetary decisions makes coordination and communication between them a fundamental necessity. Fiscal policy has a constructive impact only if it is complimented by proper decisions in the monetary field. The Reagan administration is sensitive at the moment to the meaning of this "divided system". Although the administration supports an anti-inflationary course, the present attitude of the Federal Reserve diminishes the success of the new fiscal investment incentives. Where a fiscal policy provides incentives for
investments only if they are made but does not increase internal funds, prospective investors with a lack of own funds will not invest at times of high interest rates. The result is that the intended fiscal economic stimulation is equalized. A greater interrelationship between government and the Federal Reserve Bank and more private input and participation, may improve the situation and avoid unsuccessful developments.

Fifth, a growing influence and initiative of states and municipalities has shifted some importance of fiscal decisions in respect to foreigners to the state and local level. State and municipal governments are in a much better position to use foreign capital in the most efficient sense and for very special purposes. They can provide various kinds of incentives for particular investors to replace a deficient domestic activity. Fiscal policy can be more selective and the impacts can be overlooked more easily. Cities with ambitious development plans attract foreign investors with unusually attractive incentives in times of high interest rates and a slow domestic economy. A conference of mayors of various cities of the United States in Switzerland in the early eighties confirmed this development. Several states already provide assistance or trade bureaus for foreign investors, even in foreign countries.

Sixth, the U.S. may become attractive as an investment location without any change of its own fiscal policy due to regulations and fiscal decisions in other countries. The U.S. fiscal policy has generally no influence on this situation and foreign investors may consider investments without looking at the U.S. fiscal policy.
Seventh, the effectiveness of fiscal instruments depends on how these tools are employed by the foreign investor. Though for example depreciation, rate reduction, or credits theoretically are enacted as investment incentives, they can be used for purposes not promoting investment activities.

The abovementioned seven restraints on the effectiveness of fiscal policy show that fiscal instruments may be an effective starting point in the economic management of foreign investors, but their intended success depends also on other factors located outside the reach of fiscal policy. This gap may be closed or at least narrowed by an intensified coordination and cooperation of all decision-making parties concerned.
FOOTNOTES


5) Wolozin, Harold, American Fiscal and Monetary Policy, a New York Times Book Chicago, 1970, p. 4

6) Ibid, p. 3


8) Wildavsky, op. cit., p. 1

9) Shultz, George and Dam, Kenneth W., Economic Policy Beyond the Headlines, Standford, 1977, p. 31


12) Wolozin, op. cit., p. 11

14) Kramer, op. cit., p. 8


16) Wolozin, op. cit., p. 18


18) Robinson/Morton/Calderwood, Fiscal Policy, in Davis, James W. Jr., op. cit., p. 45

19) Ott, op. cit., p. 25

20) Shultz, op. cit., p.24

21) Ibid, p. 25

22) Ott, op. cit., p. 26

23) Shultz, op. cit., p. 26

24) Ott, op. cit., p. 45


27) Ibid, pp. 50/51


29) Ott, op. cit., p. 11

30) Wolozin, op. cit., p. 19
31) Wildavsky, Ope cit., p. 283
35) Wildavsky, Ope cit., p. 135
37) Hyde and Shafritz, Ope cit., p. 308
40) Ibid.
41) Shultz, Ope cit., p. 47
43) Shultz, Ope cit., p. 44
45) Shultz, Ope cit., p. 44
46) Jacoby, Neil H., United States Monetary Policy, American Assembly, 1964, p. 143
47) Shultz, Ope cit., p. 46
49) Musgrave, Ope cit., p. 207
51) Musgrave, Ope cit., p. 746
52) Ibid, p. 746
53) Robinson/Morton/Calderwood, Ope cit., p. 45
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55) Musgrave, Ope cit., p. 704
57) Bracewell-Milnes, Barry and Huiskamp, J.C.L., Investment Incentives: A Comparative Analysis of the Systems in the EEC, the USA and Sweden, Deventer, the Netherlands, 1977, p. 23
58) Musgrave, Ope cit., p. 481
60) Ibid, p. 15
61) Smith, Ope cit., p. 22
62) Pechman, Ope cit., p. 163
63) Fromm, Ope cit., p. 133
64) Smith, op. cit., p. 22
65) Bracewell'1-Milnes, op. cit., p. 86
67) Pechman, op. cit., p. 148
68) Smith, op. cit., p. 25
69) Musgrave, op. cit., p. 555
70) Ibid., p. 487
71) Ibid., p. 487
73) The Federal Budget of the Fiscal Year 1982, p. 15
74) Shultz, op. cit., p. 28
75) Tyson, op. cit., p. 15
76) Shultz, op. cit., p. 60
77) Ott, op. cit., p. 95. Refers to political and outside lags as fiscal policy lags.
80) Tyson, op. cit., p. 17

84) See Standard Industrial Classification(SIC), Manual 1972, Executive Office of the President(OMB), prepared by the Statistical Policy Discussion, GPO, Washinton, D.C.


International Investment Survey Act of 1976, Publ.L., 94-472, 90 Stat. 2059, see appendix

87) Agricultural Foreign Investment Disclosure Act of 1978, 92 Stat. 1269, see appendix


89) 26 USC 1

90) U.S. Department Of Commerce, Foreign Direct Investment in U.S. Real Estate, p. 163


93) U.S. Department of Commerce, Foreign Direct Investment in the USA, op. cit., p. 81


95) U.S. Department of Commerce, Foreign Direct Investment in Real Estate, op. cit., p. 169

96) U.S. Department of Commerce, Foreign Direct Investment in the USA, op. cit., Appendix C, p. C-14


98) U.S. Department of Commerce, Foreign Direct Investment in the USA, op. cit., Vol. 1, p. 85

99) 16 U.S.C. 1801


101) Ibid., p. 145

102) Ibid., p. 145

103) Ibid., p. 170

105) U.S. Department of Commerce, Foreign Direct Investment in the USA, Ope cit., pp. 78/79
107) Ibid., p. 60
110) Ibid., p. 46
113) Business Week, October 19, 1981, p. 157
115) 26 U.S.C.A. sec. 151, 152
117) Ibid., p. 60
119) 26 U.S.C.A. Sec. 168
120) 26 U.S.C.A. Sec. 168(f)(8)
121) Business Week, October 21, 1981, p. 26
124) Business Week, August 24, 1981, p. 100
126) Ibid.
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129) 26 U.S.C.A. Sec. 168
130) U.S. Department of Commerce, Foreign Direct Investment in the USA, op. cit., Vol. 1, p. 88
133) 12 U.S.C. 3101
136) U.S. Department of Commerce, Foreign Direct Investment in the USA, op. cit., Vol. 1, p. 94
137) Ibid., p. 94
139) Zagaris, op. cit., p. 278
140) See Appendix; 26 U.S.C. 1
141) U.S.-German Tax Treaty, 239 UNTS 3
142) Business Week, August 24, 1981, p. 100
145) U.S. Department of Commerce, Survey of Current Business, op. cit.,
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APPENDIX

International Investment Survey Act of 1976

This act is administered by the Commerce Department. Its purpose is to acquire data concerning foreign investments in U.S. business enterprises, including any ownership of real estate, for analytical or statistical purposes. Initial reports can be required on the part of the U.S. enterprise, a foreign person (individual or entity) or its U.S. affiliates, and/or by a U.S. intermediary (such as a U.S. venture, partner, broker, agent or investment advisor), in the case of any direct or indirect establishment, purchase, merger, or other acquisition of a 10% or more voting interest in a U.S. business enterprise, or the purchase of any of the assets of an existing U.S. business enterprises, or the acquisition of real estate.

Deadlines are provided for the filling of an initial report and for certain periodic reports which may be required thereafter, including the 1980 Benchmark Survey now in progress. Exemptions from the reporting requirements are very limited, and civil and criminal penalties are provided for noncompliance.

Agricultural Foreign Investment Disclosure Act of 1978

This act is administered by the Department of Agriculture. It requires a report any time a foreign person acquires or disposes of an interest in U.S. agricultural land.

The report may be required of a: (1) foreign individual; (2) foreign corporation or other entity; (3) foreign government; or (4)
U.S. entity in which a foreign person has a direct or indirect interest of 5% or more (such as a U.S. limited partnership in which a foreign investor has a 5% interest as a limited partner). All interests in agricultural land are included with certain limited exceptions, the most important exception being a leasehold of less than 10 years.

IIAgricultural land includes all land for the production of agricultural, forestry or timber products, with very minor exceptions. The reporting requirement is determined by the use of the land at the time of acquisition, or the last use within five years of the acquisition if the land was idle at the time of acquisition and not by the anticipated use of the land after the acquisition.

A filing deadline is provided, with penalties up to 25% of the fair market value of the land, which are strictly enforced.

Foreign Investment in Real Property Tax Act of 1980

This act is administered by the Internal Revenue Service. The reporting requirements stem from the new tax provisions of this act, which generally provide that gain or loss realized by a foreign investor from the disposition of a United States real property interest after June 8, 1980, will be deemed, for U.S. tax purposes, to be taxable U.S. source income, or loss, effectively connected with a U.S. trade or business of the investor.

Real property interests generally include: (1) any interest in U.S. real property directly held by a foreign investor; and (2) stock in a U.S. that is a real property holding corporation, as defined. In addition, a foreign investor's sale of an interest in a partnership, trust or estate which owns U.S. real estate or stock in such a holding
corporation will be treated as a sale by the foreign investor of his pro rata share of such assets.

The four basic annual forms required are: (1) returns for certain domestic corporations (including certain requirements with respect to nominee holding stock in a U.S. corporation for a foreign investor); (2) returns for a partnership, trust, estate, or foreign corporation having a foreign "substantial investor"; (3) annual statements by a reporting entity to its foreign substantial investors; and (4) returns for foreign persons holding direct interests in U.S. real property. Penalties are provided for noncompliance. As soon as certain procedural rules are established in regulations to be issued by the Internal Revenue Service, vigorous enforcement of this act can be excepted.