BOOK REVIEW


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Within the last decade, foreign investment in the United States has increased to an extent unprecedented in our modern history. The causes of this often frenzied acquisition of American companies, homes, and farmland are several, ranging from the drastic decline of the dollar and the progress of Eurocommunism to the post-1973 oil price increases that have sent a veritable torrent of money to the Middle East.¹ These factors all appear likely to continue in the foreseeable future, presaging the acquisition of even more domestic companies, homes, and farmland by non-Americans.

The implications of these developments for the United States and its legal system have troubled many citizens and policymakers, but dispassionate, comprehensive analyses of this phenomenon have not been generally available.² Professor Fry's book, Financial Invasion of the U.S.A.,³ attempts to provide such an analysis and to address the policy ramifications of significant foreign investment in the United States economy. His task is not small, but his book is a major contribution to the burgeoning literature of foreign-investment regulation.

Despite its somewhat alarmist title, the book generally eschews polemics, marshaling a variety of statistical information from governmental and private sources, and presenting a fairly balanced view of the significance of this surge in foreign investment. Professor Fry begins by documenting in meticulous detail the long history of foreign—primarily Western European—investment in this country, often enlivening his account with pertinent anecdotes.⁴ Through-

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² For an impassioned treatment of this subject, see K. Crowe, AMERICA FOR SALE (1978). For the results of a major study of foreign investment undertaken at Congress's request, see U.S. DEPT OF COMMERCE, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES (1976) (nine volumes) [hereinafter cited as FOREIGN DIRECT INVESTMENT].


⁴ Id. 33-57.
out this history, he emphasizes the acquisitions of, and the positive contributions made by, investors from Canada, Japan, and Western Europe, particularly Germany and the Netherlands. This orientation—reflecting in part his residence at one time in Europe—is probably justifiable because, even today, most direct foreign investment in American companies emanates from those countries. As Professor Fry demonstrates, most of these acquisitions have generated little controversy, although there have been some prominent exceptions, such as the takeover of Pennsylvania's Copperweld Corporation by the French giant, Société Imetal, a few years ago.

But the focus of today's foreign-investment debate concerns the seemingly endless gusher of so-called "petro-dollars" coming from the oil exporting, principally Arab, countries of the Middle East. This phenomenon is much more recent in origin, being almost exclusively a product of the post-1973 period, and threatens to dwarf previous waves of foreign investment by comparison. In Professor Fry's effort to avoid hysterics, however, he minimizes the scope of recent Arab investment and the differences between such investment and the earlier European, Japanese, and Canadian experiences in this country.

This minimization of the extent of Arab investment is in part caused by the lack of data after 1977, leaving the tremendous oil profits of 1978 and 1979 necessarily unconsidered. Although this limitation might be attributable to the book's publication deadline, the lack of post-1977 data skews the figures presented by understating, perhaps unintentionally, the extent of Arab investment in the United States. The data that are presented, moreover, are woefully inadequate, as Professor Fry occasionally acknowledges. Nearly all of the analyses of foreign ownership cited are based on voluntary responses to questionnaires. Because many foreign investors, particularly Middle Eastern sheiks and potentates, tend to prefer anonymity, these data are more likely to disclose Canadian than Kuwaiti ownership.

5 See id. v.
6 "Direct" investment refers to "the direct and/or indirect ownership of 10 percent or more of the voting stock of a United States corporation—by a non-U.S. citizen." Id. 5 (quoting 3 FOREIGN DIRECT INVESTMENT, supra note 2, at A-1). See also 22 U.S.C. § 3102(10) (1976).
7 Direct investment from Canada, Japan, and Western Europe accounted for 87.8% of total foreign direct investment in the United States as of 1976. See E. Fry, supra note 3, at 9.
8 Id. 9-10.
9 Id. 5-6, 110, 144. See id. 144: It is "nearly impossible to determine how much land is actually controlled by foreign interests."
10 See id. 163 n.9.
As a legal matter, the federal government did not even begin requiring disclosure of foreign investments until 1979. The International Investment Survey Act of 1976\(^{11}\) mandates reports of foreign acquisitions of new or existing United States business enterprises,\(^{12}\) but the regulations implementing this legislation did not become effective until January 1, 1979.\(^{13}\) Similarly, the Agricultural Foreign Investment Disclosure Act of 1978\(^{14}\) requires reports of foreign acquisitions of United States farmland,\(^{15}\) but once again, the implementing regulations did not become operative until May 8, 1979.\(^{16}\) Both of these statutes impose significant civil penalties on investors who fail to comply with applicable reporting requirements,\(^{17}\) although neither the Department of Commerce nor the Department of Agriculture, the two enforcing agencies involved, has explained how it plans to ferret out nonreporting investors. That problem notwithstanding, the data these statutes will elicit will undoubtedly be superior to pre-1979 information, and it is regrettable, therefore, that Professor Fry's study could not have incorporated these new sources of information.\(^{18}\)

The dated statistical data that Professor Fry does present are further skewed by the fact that Middle Eastern investors rarely invest directly. It is common knowledge among international law specialists that foreign investors usually channel their investments through entities organized in the Netherlands Antilles, the British


\(^{12}\) An investment is reportable if the foreign owner's share of the business, including portions he controls "indirectly," constitutes at least 10% of the enterprise in question. See 22 U.S.C. § 3102(8), (10) (1976).

\(^{13}\) 15 C.F.R. §§ 806.1-17 (1980).


\(^{15}\) Reportable investments in "agricultural land" include land used for farming, forestry, or timber production. 7 U.S.C. § 3508 (Supp. III 1979).


\(^{17}\) 22 U.S.C. § 3105(a) (1976) (penalty of up to $10,000); 7 U.S.C. § 3502(a), (b) (Supp. III 1979) (penalty of up to 25% of the parcel's fair market value). The International Investment Survey Act of 1976 also includes criminal sanctions for a willful failure to file the required reports. See 22 U.S.C. § 3105(c) (1976) (fines of up to $10,000, plus imprisonment of up to one year, may be imposed on the foreign investor, including corporate officers and agents).

Virgin Islands, Liechtenstein, or some other exotic “tax haven.”\footnote{See generally W. Diamond & D. Diamond, Tax Havens of the World (1978); M. Lancer, Practical International Tax Planning (1979); A. Starchild, Tax Havens for Corporations (1979); Fry, Planning Investments from Abroad in United States Real Estate, 9 INT’L LAW. 239 (1975); Vogel, Bernstein & Nitsche, Inward Investments in Securities and Direct Operations Through the British Virgin Islands: How Serious a Rival to the Netherlands Antilles Island Paradise?, 34 TAX L. REV. 321 (1979).}

In addition to this “Delawarization”\footnote{Unlike “Finlandization” or “Balkanization,” this newly coined term does not imply any threat to the locality in question. Rather, “Delawarization” refers to the propensity of American corporations to incorporate in Delaware, despite their lack of offices, plants, or other operating facilities in that state. This phenomenon is analogous to the use of farm tax shelters by, in Professor Chirelstein’s words, “doctors, dentists, movie-stars—who have never driven a tractor or milked a cow.” M. Chirelstein, Federal Income Taxation 212-13 (2d ed. 1979).} of international finance, foreign investments may also be directed through American banks or American lawyers acting as trustees or heads of consortia.\footnote{See generally J. Bischel & R. Feinschreiber, Fundamentals of International Taxation 203-13 (1977); Surrey, International Tax Conventions: How They Operate and What They Accomplish, 23 J. TAX. 364 (1965). For a discussion on the procedural development of these treaties, see Staffs of the Joint Comm. on Taxation and the Senate Comm. on Foreign Relations, 96th Cong., 1st Sess., Tax Treaties: Steps in the Negotiation and Ratification of Tax Treaties and Status of Proposed Tax Treaties 1-2 (Joint Comm. Print 1979).} These strategies are employed for a variety of reasons other than a desire for anonymity; for example, a foreign investor may want to secure special tax treaty benefits,\footnote{See, e.g., Frazier, National Sentiment Against Land Holdings of Foreigners Strikes Chord in Oklahoma, Wall St. J., July 7, 1980, at 13, col. 4 (state attorney general warns that “Idi Amin could be your next-door neighbor”).} to avoid local agitation, or to circumvent foreign currency control laws. Irrespective of the objectives in any particular case, the consequence of these practices is the same—all foreign investment, especially that of Arab investors, is seriously understated.

On the other hand, if one thinks that foreign investment is a healthy development at the one percent level, should this assessment necessarily change at the twenty or fifty percent level? Professor Fry does not answer this question directly, but he does suggest rather strongly that the increasing paranoia\footnote{See, e.g., Frazier, National Sentiment Against Land Holdings of Foreigners Strikes Chord in Oklahoma, Wall St. J., July 7, 1980, at 13, col. 4 (state attorney general warns that “Idi Amin could be your next-door neighbor”).} on this subject is unjustified because the value of United States investments overseas exceeds the value of foreign investments in the United States, once

\footnote{E. Fry, supra note 3, at 8 (1976 data). Although large Dutch investors do exist, such as Royal Dutch Shell and Unilever, see id. 43, many investors from other countries were probably also included if they became “Dutchmen” to take advantage of the favorable Netherlands Antilles tax treaty.}
again emphasizing Western Europe. Moreover, he takes great solace in the local property law restrictions that limit the amount of land foreigners may own, although these restrictions often have more bark than bite.

Indeed, it is the dissatisfaction with these very "restrictions" that is largely responsible for the recently enacted tax on sales of United States real estate by foreign investors. This legislation eliminated a long-established tax exemption in an attempt to decrease the incentives for foreign investment, but not without raising several complex legal problems in the process. Conflicts with existing tax treaties, enforceability questions in the absence

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24 E. Fry, supra note 3, at 8, 95, 143.

25 Id. 98. These limitations necessarily vary considerably from state to state and are summarized in Appendix I, "State Restrictions on Alien Ownership of Real Estate." Id. 148-55. See also Committee on Foreign Investment in U.S. Real Estate, Foreign Investment in U.S. Real Estate: Federal and State Laws Affecting the Foreign Investor, 14 REAL PROP. PROB. & TR. J. 1, 18-49 (1979); Fisch, State Regulation of Alien Land Ownership, 43 Mo. L. Rev. 407 (1978); Griffin, Antitrust Constraints on Acquisitions by Aliens in the United States, 13 INT'L LAW. 427 (1979); Note, Regulation of Foreign Investment in U.S. Real Estate, 33 TAX L. 586, 613-22 (1980) [hereinafter cited as Regulation of Foreign Investment].

26 See Morrison, Limitations on Alien Investment in American Real Estate, 60 MINN. L. REV. 621 (1976).


of any withholding tax arrangements, and coordination with other Code sections allowing tax-deferred transactions merely head the list of difficult problems newly created. Furthermore, the notion that a tax on the sale of property is an effective way of discouraging purchases of such property is itself rather curious because such taxes do not become payable until the property is sold. Yet, Professor Fry champions this development by saying that “capital gains loopholes in U.S. tax laws that currently work to the advantage of overseas investors should also be eliminated immediately.” Why this is so is not clear from his analysis.

In any case, the tax bill recently enacted applies only to real estate investments, whether made directly or through holding companies. All other foreign investments are not affected. Why the

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31 The new tax generally does not apply if the transaction would otherwise qualify under one of the Code’s nonrecognition provisions, such as those pertaining to corporate reorganizations or exchanges of like-kind property. See I.R.C. § 897(d)(1)(B), (e)(1), added by Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, § 1122(a), 94 Stat. 2599 (1980). Certain exceptions are provided, however: for example, I.R.C. § 337, dealing with sales of corporate assets pursuant to a liquidation, does not apply to real property sales made by foreign corporations. See I.R.C. § 897(d)(2). See also I.R.C. § 897(c)(2), authorizing regulations to delineate the applicability of nonrecognition provisions where “necessary or appropriate to prevent the avoidance of Federal income taxes.”

32 The committee report explains the purpose of the tax as follows:

The committee believes that it is essential to establish equity of tax treatment in U.S. real property between foreign and domestic investors. The committee does not intend by the provisions of this bill to impose a penalty on foreign investors or to discourage foreign investors from investing in the United States. However, the committee believes that the United States should not continue to provide an inducement through the tax laws for foreign investment in U.S. real property which affords the foreign investor a number of mechanisms . . . effectively exempting him from U.S. tax on the gain realized on disposition of the property.


33 E. Fry, supra note 3, at 147.

34 See I.R.C. § 897(c), added by Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, § 1123(a), 94 Stat. 2599 (1980) (a “real property interest” can include stock in a “United States real property holding organization”—a corporation, partnership, or trust whose major asset is U.S. real estate). Extensive constructive
least mobile of all assets was thought to be the most endangered (and thus requiring control) is far from obvious, but this new tax does substantiate Professor Fry's prediction that if present restrictions on foreign investment are tightened, the new strictures will probably be applied first to real estate.\footnote{35 E. Fry, \textit{supra} note 3, at 115 (noting the possible vulnerability of United States food supplies should American agricultural land become controlled by foreign owners). See generally Gaffney, \textit{Social and Economic Impacts of Foreign Investment in United States Land}, 17 \textit{Nat. Resources J.} 377 (1977); see also Drinkhall \& Guyon, \textit{Real-Estate Purchases By Foreigners Climb, Stirring Wide Debate}, Wall St. J., Sept. 26, 1979, at 1, col. 1 (farmers believe that foreign buyers, unencumbered by capital gain taxes, are bidding up the price of United States farmland).}

Actually, this preference for foreign investments in assets other than real estate is nothing new. For many years now, state governments have virtually fallen over themselves in their efforts to entice industrial and commercial foreign investment to their states. One of the most useful aspects of this book, in fact, is the extended discussion of these development programs, their targets, and their successes.\footnote{36 E. Fry, \textit{supra} note 3, at 118-38. \textit{See also id.} 158-61 (Appendix II: "State Programs Which Provided Incentives, Special Services, and General Assistance to Attract Domestic and Foreign Industry, 1977"). In fact, the majority of these states actually maintain development offices in Europe to facilitate their efforts to attract foreign investors. \textit{Challenge in Reverse}, The Economist, Oct. 25, 1980, at 3, col. 3 (Special Survey).}

Despite these efforts, however, Middle Eastern investors have generally avoided new plant acquisitions or similar manufacturing commitments, preferring instead the safety of government securities. As a result, foreign investors as a group are the federal government's largest creditor, and Saudi Arabia is the single largest holder of Federal National Mortgage Association paper.\footnote{37 E. Fry, \textit{supra} note 3, at 94.} Indeed, bank certificates of deposit and short-term government obligations have become the principal mechanisms used thus far to "recycle" the billions of dollars spent annually on foreign oil.

This practice is not without its dangers, however, even though Professor Fry chooses not to acknowledge them. Instead, he states that "it is difficult to perceive how the OPEC [Organization of Petroleum Exporting Countries] nations could nefariously use their U.S. investments as a retaliatory weapon against American support of Israel,"\footnote{38 Id. 142.} although he concedes that a sudden withdrawal of their dollars would precipitate "some havoc."\footnote{39 Id.} He attempts to mollify ownership and asset attribution rules are also provided to prevent multitiered circumventions of the tax. \textit{See S. Rep. No. 504, supra} note 28, at 8-9.
the anxiety this scenario engenders by asserting that "there is no credible evidence available to indicate that the OPEC investors have even seriously considered such an option." But in the very next paragraph, he provides just such "credible evidence" by reporting the Arab threat to withdraw funds from Canada after Prime Minister Joe Clark suggested moving the Canadian embassy in Israel to Jerusalem. A smoking gun with someone else’s name on it perhaps, but a smoking gun nevertheless.

This Pollyannish air of unreality also permeates his discussion of the impact of massive foreign investment on American life. He does chronicle the pervasiveness of foreign investments here, from Australian ownership of the Village Voice to Dutch ownership of Good Humor ice cream, but in so doing, he implies that foreign investors are pretty much all alike and pretty much like American investors at that. This exegesis is well-written and convincing, insofar as it demonstrates that "foreign investment" is neither new nor peculiarly Middle Eastern in origin. Canadian, German, Dutch, and Japanese investors have all been active in America for some time, operating conventional businesses in largely conventional ways. That point is very important to remember in today’s emotionally charged debates, and it alone justifies Professor Fry’s exposition.

But the more recent arrival of the Middle Eastern investor may not be so easily subsumed into the general “foreign investor” paradigm. Arab governments have felt little hesitancy in attaching ideologically oriented, noneconomic conditions to their business deals. Within the last few years, in fact, Congress became sufficiently concerned about the obsequious compliance of American companies with Arab demands to boycott Israel and her trading

40 Id.
41 Id. 3, 61-64 (Table 4-3; “A Sampling of Foreign Firms Involved in the American Manufacturing Sector”), 71.
42 But see id. 73 (discriminatory employment practices of Japanese employers favoring Japanese citizens).
partners that it enacted legislation designed to penalize such practices. But there is only so much that one sovereign nation can do respecting the actions of other sovereign nations, and no doubt many of these boycott demands continue to be made. Moreover, some Arab countries do not even grant entry visas to American citizens who are Jewish or of Israeli origin, raising the specter that similar discriminations might be imposed by Arab owners who take over domestic operations. By failing to recognize the uniquely ideological orientation of many Arab investors, Professor Fry may have unduly sanitized a debate that demands more unsettling analysis.

Finally, foreign investment is but one rivulet in the stream of international commerce. Import restrictions, comparative wage scales, abundance of natural resources, transportation facilities, market access, and currency exchange rates all affect the amount of foreign capital that comes to this country. The Middle Eastern

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45 See Kaplan, supra note 44, at 340 & n.182 (visa restrictions imposed by Saudi Arabia and the United Arab Emirates).

46 See Marsh, Book Review, COMMENTARY, Feb. 1978, at 86, 88 (noting restrictive hiring by American architectural firms doing business in the Middle East). Another manifestation of this discriminatory attitude was the attempt, eventually unsuccessful, by the Kuwait International Investment Company to have Merrill, Lynch, Pierce, Fenner & Smith exclude "Jewish" banks from two bond issues comanaged by the Kuwait Company and Merrill Lynch. Arab Boycott Report, supra note 43, at 11. When such discrimination can be proved, the aggrieved party may have a claim under the Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241 (codified in scattered sections of 28, 42 U.S.C.), but proof problems are often difficult in this area. See Comment, The Arab Boycott and Title VII, 12 Harv. C.R.-C.L. L. Rev. 181 (1977).

47 For example, during the seven years ending April 1978, the dollar fell in value 63% against the Japanese yen, 81% against the German mark, and 131% against the Swiss franc. E. Fry, supra note 3, at 36. When combined with major declines in United States stock prices, which reduced the dollar cost of American companies, these currency fluctuations meant that foreign investors could act like hungry children in a candy store armed with $20 bills. See also Katz, supra note 1, at 474-76.
phenomenon is, once again, quite unique in this regard. It is inextricably intertwined with a massive transfer of wealth that is both ongoing and unparalleled. In 1980, for example, the Arab nations are expected to amass dollar surpluses for this one year of $120 billion, up from $5.3 billion as recently as two years ago.48 Put simply, the frequent oil price boosts by OPEC have concentrated more disposable income in fewer hands than ever before.49 Hands, by the way, that understand quite clearly where the relative balance of economic "interdependence" lies,50 as the recent debacle involving the film "Death of a Princess" vividly demonstrated.51

To make matters worse, significant portions of these massive dollar surpluses have been deposited, on short-term basis, in major American banks, who have then loaned these funds to poor Third World countries seeking cash to buy their oil.52 In fact, these loans to less developed countries already exceed the combined equity capital and loan loss reserves of the banks involved by some thirty percent.53 By combining the treachery of lending long while

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49 By the end of 1980, the Arab nations will have $340 billion invested worldwide, a tripling of their cumulative investment since 1975. Fully 80% of this total represents the investments of just four countries: Iraq, Kuwait, Saudi Arabia, and the United Arab Emirates. Arab Banks Grow, BUSINESS WEEK, Oct. 6, 1980, at 70, 73. See generally Kaplan, International Economic Organizations: Oil and Money, 17 HARV. INT'L L.J. 203 (1976); Lillich, Economic Coercion and the International Legal Order, 51 INT'L AFF. 558 (1975); Mirvahabi, Claims to the Oil Resources in the Persian Gulf: Will the World Economy Be Controlled by the Gulf in the Future?, 11 TEX. INT'L L.J. 75 (1976).
53 Moynihan, A Pattern of Failure, Wall St. J., Aug. 19, 1980, at 28, col. 4. For an explanation why the Arab countries prefer having an American bank act as their intermediary in these transactions, see Quirk, Third World Loans Could Break Our Banks, BUS. & SOC'Y REV. 39, 40 (Fall 1979) and Vicker, Arab Nations Grow-
borrowing short with the lunacy of lending capital funds for current expenses, the leading banks of this country have been positioned quite literally between Scylla and Charybdis. As a result, the bedrock of our banking system is now largely subject to the whim of these "foreign investors."

The genuine financial risks and unique political characteristics of the recent surge in Arab country investment demands that these investments be analyzed separately from other, more traditionally oriented foreign investments. By following the all too common practice of ignoring this distinction, Professor Fry simply substitutes myopia for xenophobia and weakens his book's usefulness and importance.


54 The devastating effect this practice had on New York City's fiscal condition is discussed generally in F. Ferretti, The Year the Big Apple Went Bust (1976) and Adams, Why New York Went Broke, Commentary, May 1976, at 31.