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Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649739653

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WP 786-75a (April 1975) REVISED May 1975

I. INTRODUCTION

While most of the discussion about the implications of the accumulation of vast dollar reserves by members of the Organization of Petroleum Exporting Countries has focused on macroeconomic issues, there has been a growing concern with their ability to purchase equity positions in U.S. business enterprises of sufficient magnitude to provide potential for managerial control. Even though a Congressman's warning that, "they (small oil exporting nations) can buy our nation like meat in the market place..."[1] can be dismissed as hyperbole, it is clear that both the level and intensity of discussion of OPEC foreign investment in the U.S. have increased. The Congress is investigating the extent and nature of foreign ownership and rather strict reporting requirements are being considered.

The intensity of the reaction to potential OPEC investment results from the combination of two factors. First, concern over foreign investment in the U.S. has mounted in recent years as its magnitude has increased. Second, OPEC investment, in particular, has been singled out due to the economic and political issues associated with the Mid-eastern problem in general. The primary concern appears to be with foreign direct investment (FDI) in which the investor exercises or has the potential to exercise management control, rather than foreign portfolio investment (FPI) in which the investor has only a financial interest.[2]

This article addresses the extent to which the shift of wealth to oil exporting countries will result in large scale direct invest-

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ment in major U.S. enterprises by government or private interests of the oil exporting nations. The paper concludes that large scale FDI in U.S. enterprise by OPEC members is unlikely. We will attempt to show that a conclusion to the contrary would conflict with existing theory and evidence about the determinants of foreign direct investment and ignore evidence of past behavior on the part of OPEC investors or would require an assumption that FDI will be utilized to achieve ends which can be attained more efficiently and effectively through other means.

II. PORTFOLIO AND DIRECT INVESTMENT: THE THEORETICAL BASIS

Large scale flows of foreign investment are by no means a new phenomenon. Just prior to the start of World War I 25 to 40 percent of gross domestic savings of the three major creditor countries, Great Britain, France, and Germany, were invested abroad.[3] However, the vast majority of pre-1914 investment was portfolio rather than direct.[4] Investors purchased financial instruments--typically bonds--which promised a higher rate of return than that available at home.[5] Given the increase in the relative importance of equity markets, it is now recognized that portfolio capital flows also take place in order to diversify investment risks.[6] This suggests, of course, that capital will not flow in only one direction--to the country where capital is most scarce and therefore its productivity highest--but will move in many directions as investors continuously seek to balance risks.

In contrast, a large proportion of post World War II foreign investment has been direct rather than portfolio.[7] This is especially true for U.S. investment abroad, but it also is becoming the case for non-U.S. investment, including investment into the U.S. It is perhaps misleading to classify direct investment as a capital flow at all. Its essence is control in the managerial sense; what Kindleberger refers to as "the locus of decision making power."[8] Dunning goes

directly to the heart of the matter;"...direct investment implies the investing unit (usually a business enterprise) purchases the power to exert some kind of control over the decision taking process of the invested in unit (again, usually a business enterprise.)"[9] Direct investment is typically a flow of resources or factor inputs such as management, technology, and marketing skills that may or may not be accompanied by a flow of capital. Capital may be transmitted from the source country, equity may be obtained in exchange for management or technology, or very typically, it may be raised locally (both initially and through the reinvestment of earnings). "Direct investment represents not so much an international capital movement as capital formation undertaken abroad."[10]

Given that FDI entails a cross-boundary transfer of resources, often across considerable distances, to compete with local enterprise some advantage is required to compensate for imperfect knowledge of the host environment and the added costs imposed by both geographic and cultural distances. Clearly, under perfectly competitive conditions no such advantage could exist; any initial managerial or technical advantage possessed would be readily available to local enterprise. However, the world of foreign direct investment is not perfectly competitive. As Kindleberger notes, FDI is a function of imperfections in both goods and factor markets.[11] The foreign investor typically exploits a monopolistic advantage which allows him to earn a higher return from a given asset than can be extracted by a local investor. Restrictions on the free flow in information allow the foreigner to offset the disadvantages distance imposes through advantages such as superior management or technology. Caves observes that FDI is a direct function of the ability to capture monopoly rents, either through horizontal investments in oligopolistic industries characterized by differentiated products or through vertical integration in extractive industries.[12]