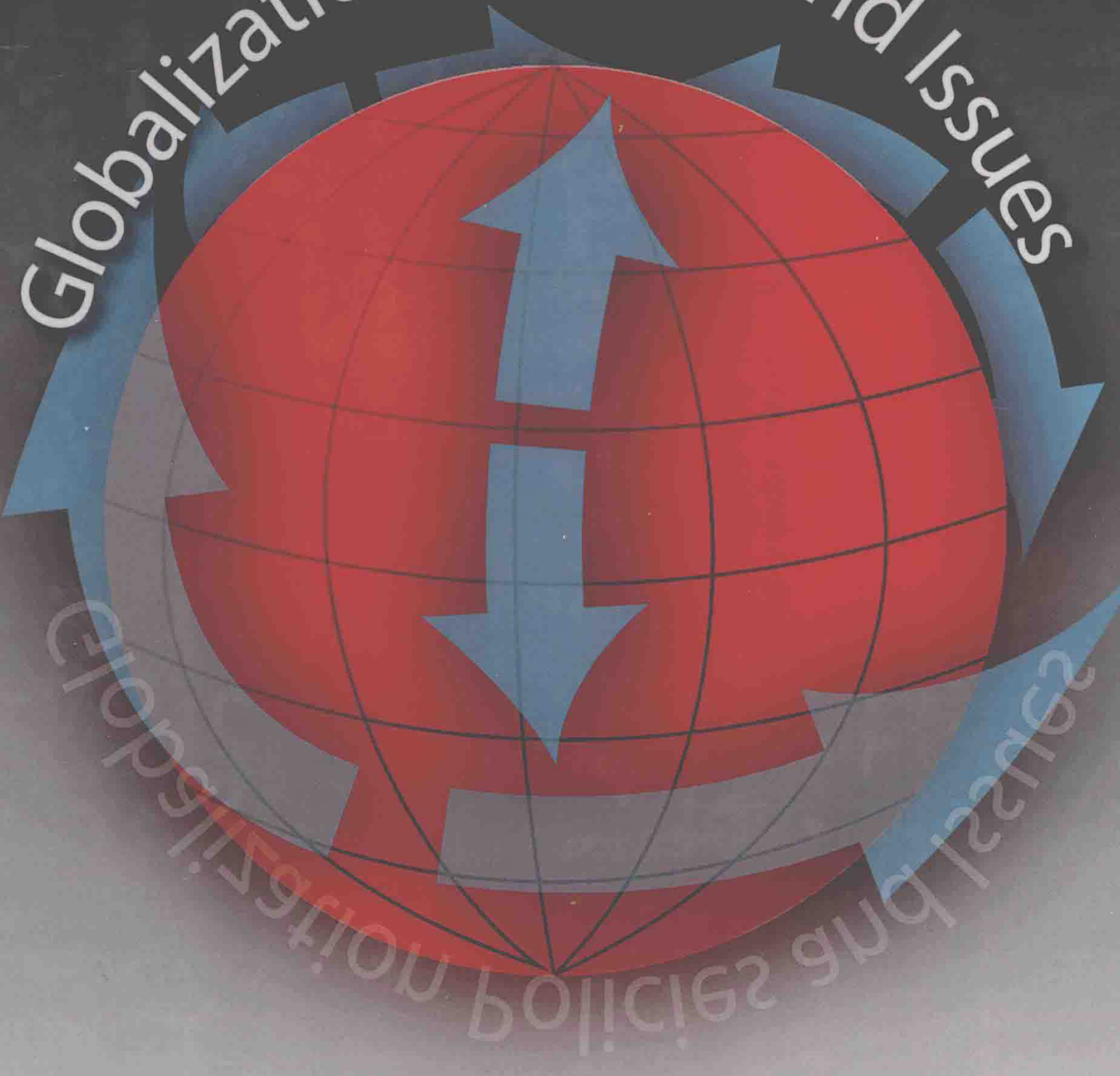
Global Economic Studies

# Globalization Policies and Issues



Brandon J. Sherman
Editor

NOVA

GLOBAL ECONOMIC STUDIES

# GLOBALIZATION POLICIES AND ISSUES

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# PREFACE

Globalization describes a process by which regional economies, societies and cultures have become integrated through a global network of communication, transportation and trade. However, as a result this integration, various policies and issues come about. This book examines a variety of issues related to globalization and the policies which are put into place due to this global network.

Chapter 1 - Globalization has placed new demands on statistical agencies to provide the information necessary to inform policy in today's increasingly interdependent world economy. This phenomenon has manifested itself in the interdependence of financial markets, the increasing role of multinational corporations (MNCs), the transfer of technology, the increasing dependence of domestic markets on foreign trade, increasing trade in services, and greater interdependence of monetary, fiscal, investment, and regulatory policy. Indeed, this interdependence in policy has led to increased demands for harmonization in world statistical standards. These have led to efforts by countries and international organizations to more closely adhere to international economic statistical standards; the updating of the *System of National Accounts*, the International Monetary Fund's *Balance of Payments Manual*, and the OECD *Benchmark Definition of Foreign Direct Investment*; the issuance of the OECD Handbook on Globalization Indicators; development of international data dissemination standards; and the development and issuance of a series of handbooks ranging from international trade in services to tourism.

Chapter 2 - In a dispute settlement case (DS267) brought by Brazil against certain aspects of the U.S. cotton program, a WTO Appellate Body (AB) recommended in March 2005 that the United States remove certain "prohibited subsidies" by July 21, 2005, and remove the adverse effects resulting from certain "actionable subsidies" by September 21, 2005. When the United States failed to meet these deadlines, Brazil claimed the right to retaliate against $3 billion in U.S. exports to Brazil based on the prohibited subsidies, and proposed $1 billion in retaliation based on the actionable subsidies. The United States objected to these retaliation amounts and requested WTO arbitration on the matter. However, in mid-2005 the United States and Brazil reached a procedural agreement to temporarily suspend retaliation proceedings.

On August 21, 2006, Brazil submitted a request for a WTO compliance panel to review whether the United States has fully complied with panel and AB rulings. The United States blocked the WTO's Dispute Settlement Body (DSB) from approving Brazil's request on August 31, 2006; however, Brazil is expected to make a second request (which the United States will be unable to block) at the DSB meeting set for September 28, 2006. If a compliance panel finds that the United States has not fully complied with the AB rulings, Brazil could ask the WTO arbitration panel to resume its work. Although the United States has already complied with a portion of the AB's recommendation by eliminating the Step 2 program (August 1, 2006), additional permanent modifications to U.S. farm programs may still be needed to fully comply with the WTO ruling on "actionable subsidies." This report will be updated as events warrant.

Chapter 3 - Dispute resolution in the World Trade Organization (WTO) is carried out under the WTO Dispute Settlement Understanding (DSU), whose rules and procedures apply to virtually all WTO agreements. The DSU provides for consultations between disputing parties, panels and appeals, and possible compensation or retaliation if a defending party does not comply with an adverse WTO decision by a given date. Automatic establishment of panels, adoption of reports, and authorization of requests to retaliate, along with deadlines for various stages of the dispute process and improved multilateral surveillance and enforcement of WTO obligations, are aimed at producing a more expeditious and effective system than that which existed under the GATT. To date, 349 WTO complaints have been filed, slightly more than half of which involve the United States as a complaining party or defendant. Expressing dissatisfaction with WTO dispute settlement results in the trade remedy area, Congress directed the executive branch to address dispute settlement issues in WTO negotiations in its grant of trade promotion authority to the President in 2002 (P.L. 107-210). WTO Members had been negotiating DSU revisions in the now-suspended WTO Doha Round, though a draft agreement was not produced. S. 817 (Stabenow), S. 1542 (Stabenow), S. 2317 (Baucus), and H.R. 4186 (Camp) would each establish a new position in the Office of the United States Trade Representative (USTR) to help the USTR investigate and prosecute WTO disputes. S. 2467 (Grassley) would make the USTR General Counsel a confirmable position expressly responsible for WTO dispute settlement. H.R. 4733 (Rangel) and H.R. 5043 (Cardin) would create new congressional entities with functions related to WTO disputes. This report will be updated as events warrant.

Chapter 4 - The United States and many of its trading partners use laws known as trade remedies to mitigate the adverse impact of various trade practices on domestic industries and workers.

U.S. antidumping laws (19 U.S.C. 1673 *et seq.*) authorize the imposition of duties if (1) the International Trade Administration (ITA) of the Department of Commerce determines that foreign merchandise is being, or likely to be sold in the United States at less than fair value, and (2) the U.S. International Trade Commission (ITC) determines that an industry in the United States is materially injured or threatened with material injury, or that the establishment of an industry is materially retarded, due to imports of that merchandise. A similar statute (19 U.S.C. 1671 *et seq.*) authorizes the imposition of countervailing duties if the ITA finds that the government of a country or any public entity has provided a subsidy on the manufacture, production, or export of the merchandise, and the ITC determines injury. U.S. safeguard laws (19 U.S.C. 2251 *et seq.*) authorize the President to provide import relief from injurious surges of imports resulting from fairly competitive trade from all countries. Other safeguard laws authorize relief for import surges from communist countries (19 U.S.C. 2436) and from China (19 U.S.C. 2451). In each case, the ITC conducts an investigation, forwards recommendations to the President, and the President may act on the recommendation, modify it, or do nothing.

WTO dispute settlement panels and Appellate Body rulings found that the United States is in violation of its WTO obligations with regard to two U.S. trade remedy laws — the

Continued Dumping and Subsidy Offset (CDSOA, also known as the Byrd Amendment) and the Antidumping Act of 1916, which was subsequently repealed in P.L. 108-429. In the 109th Congress, S. 1932 (signed by the President on February 8, 2006, P.L. 109-171) repealed the CDSOA while allowing disbursements under the act to continue for merchandise entering the United States before October 1, 2007. Other trade remedy-related legislation, including H.R. 3283 (English, passed House July 27, 2005), S. 1421 (Collins), and H.R. 3306 (Rangel) seek to modify AD and CVD provisions in order to target alleged circumvention of trade remedy duties, particularly on subject imports from China. Other bills containing similar provisions include S. 593 (Collins) and its companion bill H.R. 1216 (English). Section 3 of H.R. 1493 (Tim Ryan), defines manipulation of foreign exchange rates as a countervailable subsidy. H.R. 4217 (Knollenberg) seeks to allow U.S. manufacturers to participate in AD and CVD investigations as interested parties. H.R. 5529 (English), seeks to make modifications to safeguard laws, as well as amending AD and CVD legislation.

This report explains, first, U.S. antidumping and countervailing duty statutes and investigations. Second, it describes safeguard statutes and investigative procedures. Third, it briefly presents trade-remedy related legislation in the 109th Congress. The appendix provides a chart outlining U.S. trade remedy statutes, major actors, and the effects of these laws.

Chapter 5 - On July 24, 2006, the WTO's Director General announced the indefinite suspension of further negotiations in the Doha Development Agenda or Doha Round of multilateral trade negotiations. The principal cause of the suspension was that a core group of WTO member countries — the United States, the European Union (EU), Brazil, India, Australia, and Japan — known as the G-6 had reached an impasse over specific methods to achieve the broad aims of the round for agricultural trade: substantial reductions in trade-distorting domestic subsidies, elimination of export subsidies, and substantially increased market access for agricultural products.

The WTO is unique among the various fora of international trade negotiations in that it brings together its entire 149-country membership to negotiate a common set of rules to govern international trade in agricultural products, industrial goods, and services. Agreement across such a large assemblage of participating nations and range of issues contributes significantly to consistency and harmonization of trade rules across countries. Regarding agriculture, because policy reform is addressed across three broadly inclusive fronts — export competition, domestic support, and market access — WTO negotiations provide a framework for give and take to help foster mutual agreement. As a result, the Doha Round represents an unusual opportunity for addressing most policy-induced distortions in international agricultural markets.

Doha Round negotiators were operating under a deadline effectively imposed by the expiration of U.S. Trade Promotion Authority (TPA), which permits the President to negotiate trade deals and present them to Congress for expedited consideration. To meet congressional notification requirements under TPA, an agreement would have to have been completed by the end of 2006. That now appears unlikely. TPA expires on June 30, 2007, and most trade experts and officials think that the authority would not be renewed.

As a result of the suspension of the negotiations, a major source of pressure for U.S. farm policy change will have dissipated. The current farm bill expires in 2007, and many were looking to a Doha Round agreement to require changes in U.S. farm subsidies to make them more compatible with world trade rules. The option of extending the current farm law appears strengthened by the indefinite suspension of the Doha talks. The United States must still meet obligations under existing WTO agricultural agreements, which limit trade-distorting spending to $19.1 billion annually. Some trade analysts think that, now that the Round has been suspended, there could be an increase in litigation by WTO member countries that allege they are harmed by U.S. farm subsidies.

This report assesses the current status of agricultural negotiations in the Doha Round; traces the developments leading up to the December 2005 Hong Kong Ministerial; examines the major agricultural negotiating proposals; discusses the potential effects of a successful Doha Round agreement on global trade, income, U.S. farm policy, and U.S. agriculture; and provides background on the WTO, the Doha Round, the key negotiating groups, and a chronology of key events relevant to the agricultural negotiations. The report will be updated.

Chapter 6 - World Trade Organization (WTO) Members must grant immediate and unconditional most-favored-nation (MFN) treatment to the products of other Members with respect to tariffs and other trade-related measures. Programs such as the Generalized System of Preferences (GSP), under which developed countries grant preferential tariff rates to developing country products, are facially inconsistent with this obligation because they accord goods of some countries more favorable tariff treatment than that accorded to goods of other WTO Members. Because such programs have been viewed as trade-expanding, however, Contracting Parties to the General Agreement on Tariffs and Trade (GATT) provided a legal basis for one-way tariff preferences and certain other preferential arrangements in a 1979 decision known as the Enabling Clause. In 2004, the WTO Appellate Body ruled that the Clause allows developed countries to offer different treatment to developing countries, but only if identical treatment is available to all similarly situated GSP beneficiaries. Where WTO Members' preference programs have provided expanded benefits, the WTO has on occasion waived Members' WTO obligations. A number of trade preference bills have been introduced in the 109th Congress, including proposed extensions of the GSP and Andean preference programs, each of which is set to expire in 2006. Among these are H.R. 5070, which would extend the GSP and Andean preferences for one year and expand and extend textile benefits under the African Growth and Opportunity Act (AGOA); H.R. 6076 and S. 3904, which would extend until 2008 the GSP, Andean preferences, and a third-country fabric provision for lesser-developed beneficiaries expiring in 2007; and H.R. 6142, which would extend the GSP and the AGOA third-country fabric provision until 2008 and expand textile and apparel benefits for Haiti. This report will be updated.

Chapter 7 - Different forces and potential benefits are pushing towards increasing financial globalization. However, globalization can carry important risks. This paper reviews the literature on crises and contagion in the context of financial globalization. Countries with weak fundamentals become more prone to crises when they liberalize their financial sectors. Globalization can also lead to crises in countries with sound fundamentals, due to imperfections in financial markets or external factors. Moreover, open economies are exposed to contagion via different channels such as real links, financial links, and herding behavior. Still, in the long run, the net effects of financial globalization are likely to be positive. The main challenge for policymakers is thus to manage the process as to take advantage of the opportunities, while minimizing the risks.

Chapter 8 - The political, economic and socio-cultural forces of globalization create new opportunities as well as challenges for states and policy makers in conjunction with their relative positioning within global political economy and security structures. However, the orthodox neoliberal discourse on development and economic policy making has promoted stereotyped responses to substantially diverse local and regional socioeconomic problems, and sought to enforce them through international financial institutions and institutional restructuring. In this context, the State Planning Organization in Turkey represents a striking example of institutional transformation under the strain of global discourses on development in the sense that it was formed and promoted during the heyday of structuralism, and became subject to a systematic policy of marginalization from the main policy network owing to the multifaceted pressures of neoliberal globalization.

Chapter 9 - We are living in a tide of "globalization" that reaches to the urban and rural humans alike, to all corners of the earth, for pro or con, without exception. The process of globalization enhances technological culture where everything is directed to accumulate wealth, and that humanity globally experiences immense change and upheaval in social consensus and is being reshaped with new fabrics. The technological culture and market-based globalization fail to satisfy the full spectrum of human needs, as well as satisfy emotional, spiritual and creative dimensions of human aspiration. On the other hand, this consensus of economic development and the process of globalization deepen material scarcity and poverty that translate directly into human suffering. The concepts and behavioural patterns that impact religions and religious experiences of people around the world are rapidly changing. One irony at this religious and historical turning point of humanity is that it failed to understand the essence or core values of religions. Instead of receiving the values and rich heritages of religions it is being used for vested interest, and such a consensus leads many to involve violence. Religions are also used for finding justification for war and violence. Thus, terrorism and violence exist in the modern arena and challenge the peaceful existence of people around the globe.

Chapter 10 - The rapid expansion of international tourism has motivated growing interest in forecasting studies. The developments in tourism forecasting methodologies fall into several streams among which the computational methods seem to be capable to beat the traditional ones. This study reviews the principal applications in tourism demand forecasting of different techniques based on Computer Sciences and underlines inappropriate methodological procedures carried out in previous research. Furthermore, it also suggests potential lines of future research such as the use of new forecasting methods (Evolutionary Neural Networks and Data-Fusion) or the possible existence of chaotic dynamics in tourist time series.

Chapter 11 - In the ongoing globalization of business, *transnational* industrial relations systems are emerging as complements to the traditional *national* systems. Integral to the emergent transnational systems are International Framework Agreements (IFAs). This chapter shows that a previously unrecognised key aspect of IFAs is that they shift the locus of influence in the union movement from national unions to either global union federations or enterprise level unions. Based on a study of an IFA signing process, this chapter shows how this tension between different levels of the union movement affected both the IFA signing process and the IFA content. The outcome in the studied case was that the locus of influence was decentralized to the enterprise level union. This result challenges the prevalent argument that IFAs centralize influence to global union federations. Instead, this chapter proposes that the locus of influence will be decentralized to the enterprise level when: i) there is a trustful corporate-enterprise level union relation, ii) there is a distrustful corporate-global level union relation, and iii) the corporate driver for adopting an IFA is to foster its relations with its enterprise level union. On the other hand, the locus of influence will be centralized to the global level when: i) there is a distrustful corporate-enterprise level union relation, ii) there is a trustful corporate-global level union relation, and iii) the corporate driver for adopting an IFA is to improve its external legitimacy.

Chapter 12 - In the 21st century it is expected that "*global syndromes* "and or global imbalances/ disparities will be appeared in the human society. The global issues seem likely to confront with every country around the world co-existing on the planet Earth. As a matter of fact, trade policy in the globalizing world should be modified in coping with such historical trends for sustainable global economy.

The FUGI (Futures of Global Interdependence) global modeling system has been developed as a scientific policy modeling and simulation tool of providing global information to the human society and finding out possibilities of policy coordination among countries in order to achieve sustainable development of the global economy under the constraints of rapidly changing global environment. The FUGI global model M200 classifies the world into 200 countries/regions where each national/regional model is *globally interdependent* through international trade, oil prices, export/import prices, financial flows, ODA, private foreign direct investment, exchange rates, stock market prices and global policy coordination etc. The purpose of this article is twofold, namely to provide information on the alternative futures of *fluctuated* global economy by *global model simulations* as well as *appropriate trade policies for sustainable development of the interdependent global economy. It is worth noting that not only appropriate harmonized adjustments of international trade but wise cosmic mind to promote human solidarity with the ever changing nature will be desirable to adjust orbit of the fluctuated global economy.*

# CONTENTS

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*Chapter 1*

# Globalization, Offshoring, and Multinational Companies: What Are the Questions, and How Well Are We Doing in Answering Them?

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## I. Introduction

Globalization has placed new demands on statistical agencies to provide the information necessary to inform policy in today's increasingly interdependent world economy. This phenomenon has manifested itself in the interdependence of financial markets, the increasing role of multinational corporations (MNCs), the transfer of technology, the increasing dependence of domestic markets on foreign trade, increasing trade in services, and greater interdependence of monetary, fiscal, investment, and regulatory policy. Indeed, this interdependence in policy has led to increased demands for harmonization in world statistical standards. These have led to efforts by countries and international organizations to more closely adhere to international economic statistical standards; the updating of the *System of National Accounts*, the International Monetary Fund's *Balance of Payments Manual*, and the OECD*Benchmark Definition of Foreign Direct Investment*; the issuance of the OECD Handbook on Globalization Indicators; development of international data dissemination standards; and the development and issuance of a series of handbooks ranging from international trade in services to tourism.

Much of this work has involved filling gaps in coverage required by changes in the economy using conventional data collection methods and the existing structure of the national accounts. Providing the information needed for evaluating the economic impact of MNCs, however, normally requires the development of direct surveys of companies that capture data on the overseas activities of their foreign affiliates. It also may require the use of alternative estimation methods. Despite the cost to statistical agencies and the burden imposed on business respondents by surveys, the sheer size, growth, and impact of multinational companies have motivated a number of countries to develop, or consider developing, data based on surveys of MNCs.

The United States is the world's largest direct investor and also the world's largest recipient of inward direct investment. At yearend 2004, the value of the U.S. direct investment position abroad at current-cost was $2.4 trillion, and the value of the foreign direct investment position in the United States at current-cost was $1.7 trillion. In 2003, U.S. exports and imports of goods associated with U.S. parent companies, their foreign affiliates, and U.S. affiliates of foreign companies totaled nearly $1.2 trillion and accounted for more than half of U.S. imports and over two-thirds of U.S. exports. These companies employed about 35 million people in the United States and abroad in 2003 (25 million were in the United States, of a total workforce of about 130 million). The combined gross product of U.S. parents and U.S. affiliates accounted for more than one-fifth of the U.S. gross domestic product for private industries.

Recent estimates by the United Nations illustrate the significance of MNCs worldwide [1]. The U.N. estimates worldwide sales by foreign affiliates in 2003 at $17 trillion, or nearly double the size of world exports. By comparison, in 1990, sales by foreign affiliates were only about 25 percent larger than world exports. Over the period 1990-2004, the world stock of outward direct investment increased an average of 12 percent per year, from $1.8 trillion to $9.7 trillion, compared to an annual growth rate of world current-dollar GDP of 4.2 percent. In 2004, foreign affiliates accounted for one-third of world exports.

By any measure, it is clear that MNCs are large and important, and that their role and influence has expanded as they have rapidly grown in recent years. Coincidental with this growth, the questions that policymakers, the academic community, and others are asking about MNCs have also become more numerous and varied. Public awareness of the offshoring of services has recently led to renewed focus on MNCs and the decisions they make in determining where and by whom their business functions will be performed. The United States has what is widely recognized as the most extensive statistical program in the world for tracking the activities of MNCs, and it is one that we continually strive to improve. In this regard, to be able to analyze questions about MNCs or offshoring and address concerns, the U.S. Congress has recently provided incremental funds for the collection of new information, and for the development, acceleration, and/or modernization of presentations of this information.

This paper identifies key questions that are being asked about the role and impact of MNCs and then reviews the types of statistics that are required to answer those questions. The paper goes on to assess whether the statistics collected by the Bureau of Economic Analysis (BEA) are adequate to address those questions. In so doing, it highlights questions that cannot be readily answered just through data collections but that also require the use of economic theory, modeling techniques, and statistical inference. Finally, it identifies steps that might be considered to address data weaknesses and to help policy makers and other data users better answer the important questions that they now are asking about the impact of MNCs.

# II. What Questions Are Being Asked about MNCs?

The following summary attempts to lay out the key questions, provide the answers yielded by U.S. data on MNCs, and identify some of the remaining unanswered questions and the additional data that may be needed. The questions are largely drawn from academic research and policy studies. It is, of course, impossible to develop a complete list of all the questions that people are asking about MNCs, but it is possible to identify key questions that are being asked by leading policymakers, researchers, and others who have extensive knowledge and experience with issues concerning MNCs, globalization, and offshoring issues more generally.

## A. Brief History

Before attempting to evaluate how well we may be doing in answering the key questions, it may be informative to put BEA's current data collection efforts and studies in an historical context. Some information on direct investment was collected by the U.S. Government in the early 1900s, but systematic data collection did not begin until around 1950. At that time, some data on the overall operations of parent companies and affiliates began to be collected, but the focus was on the data needed to compile the U.S. balance of payments accounts; the overall operations data tended to be viewed as supplements to the balance-of-payments data and were used mainly to analyze the balance-of-payments effects of direct investment, such as the extent to which production abroad by the foreign affiliates of U.S. companies substituted for, or was complementary to, U.S. exports. Until about the mid-1970s, much greater emphasis was placed on the data for U.S. direct investment abroad (outward investment), which, at the time, was far greater than foreign direct investment in the United States (inward investment).

With the continued growth in outward investment and with the acceleration in the growth of inward investment in the 1970s and 1980s, interest in the non-balance-of-payments aspects of direct investment (such as its effects on employment, technology transfer, and domestic production) increased correspondingly, and equal emphasis came to be placed on collecting data on investment in both directions. In response, BEA expanded its data on the overall operations of U.S. parent companies and their foreign affiliates and instituted new surveys to collect data on the overall operations of the U.S. affiliates of foreign companies.

As concern over the rapid growth in inward investment increased during the late 1980s, Congress and the general public demanded more information to assess the impact of inward investment in particular industries and states. This call led to efforts to link BEA's enterprise-level data on direct investment to establishment-level data from the Census Bureau and Bureau of Labor Statistics, to obtain those agencies' more detailed data by industry and state for the foreign-owned U.S. companies that report to BEA. This project represented one of a number of improvements that have been made simply by better utilizing existing data, without imposing additional reporting burdens on the business community. Other major data improvement projects that did not impose additional respondent burden were the development of estimates of affiliate value added; the development of a supplemental, ownership-based framework of the current account; and BEA's revaluations of direct investment from historical cost, or book value, to estimates based on current market prices.

Today, BEA provides policymakers and researchers with a wide array of MNC data items cross-classified by country, industry, and state. BEA's surveys of direct investment include employment data, RandD expenditures, trade in goods and services, and selected financial data [2].Extensive data at aggregate and detailed levels are provided to the public free of charge on BEA's Web site at <www.bea.gov>. While BEA must maintain strict confidentiality of micro-level data, a special program allows access to micro-level data for distinguished researchers working in the area of foreign direct investment or trade in services.

BEA has conducted significant methodological and conceptual work, which has led to the collection of additional data items and the refinement of concepts. In addition, BEA has been actively involved in work throughout the world, in clarifying concepts and in exploring the borderline between direct investment and other types of investment. For example, staff have actively contributed to the development of the *Balance of Payments Manual*, the *Manual of Statistics on International Trade in Services*, the *Benchmark Definition of Foreign Direct Investment*, and the *System of National Accounts*. In addition, they actively participate in various international workgroups, examining such issues as direct investment, nonperforming loans, the measurement of software trade, the measurement of insurance services, and various other measurement and statistical issues.

In these ways, BEA has responded to the need for more relevant information for use in analyzing and understanding the role of MNCs in the globalization process. Throughout the history of its data collection program, BEA has taken steps to improve the accuracy and timeliness of its data. However, in this era of globalization, working to improve the accuracy and timeliness of direct investment data is no longer sufficient. Comparability of the data, both to data on the domestic economy and to the data of other countries, is also necessary [3]. Also, to minimize respondent burden and maximize data utility, it is essential to organize and enhance the data that are obtained [4]. In recent years, BEA, its counterpart agencies in other countries, and international organizations have paid increasing attention to improving the comparability of MNC data across countries and, for a given country, to data for the domestic economy to which the data might be compared.

## B. What Are the Questions, and How Well Are We Answering Them?

The United States has made major strides in providing information that has been used to answer many of the key questions being asked about globalization. Some of these key questions are:

*How do MNCs affect output, incomes, and employment in home and host economies? Do multinationals export jobs? How do they affect wages?* [5]

A frequently expressed fear is that multinational companies will shift production offshore to lower wage countries, thereby exporting jobs and exerting downward pressure on wages back home. BEA's data suggest that multinationals generally invest abroad for access to markets rather than low wages and that the share of their activities conducted abroad has not increased appreciably over time. According to BEA's data, worldwide value added, capital expenditures, and employment of U.S. MNCs remained concentrated in the United States in 2003. U.S. operations' share of the worldwide value added, capital expenditures, and employment of U.S. MNCs in 2003 was 74 percent, 74 percent, and 72 percent, respectively, down somewhat from 1977 when the shares were 75 percent, 79 percent, and 78 percent [6]. These shares have remained relatively stable over this period of rapid globalization.

Evidence also suggests that the wage rates of parent companies are not significantly affected by the wage rates of their foreign affiliates [7]. In addition, studies suggest that output in both the home and host countries is positively correlated with new direct investments, and that foreign direct investment may lead to knowledge "spillovers" with other firms in the host economy. The impact on host and home country employment from new direct investments is unclear [8]. However, this lack of clarity has less to do with absence of data on employment than it does with disentangling the impact of new foreign direct investment from macroeconomic and industry specific factors that also affect domestic employment. This point is revisited later in this paper.

*What determines the location of production by multinationals?*

BEA's data on foreign direct investment has helped refute one of the major fallacies about multinationals, which is that the most important determinant of the location of their overseas investment is access to low wage labor. Indeed, the most important determinant seems to be access to large and prosperous markets. Companies tend to invest for purposes of *selling* goods and services rather than for gaining access to low-cost labor and other resources for *producing* goods and services. Two-thirds of U.S. direct investment abroad is in high-income countries. Interestingly, in manufacturing, 80 percent of overseas affiliates' production is in high-wage, developed countries, where investment is stimulated by a number of non-wage factors, including access to markets; production of products designed for the local market; local service, support, sales, and advertising activities; tax incentives; or reduced transport costs.

*How do MNCs respond to barriers to trade and investment? To tax and investment incentives?*

As suggested above, the major determinant of foreign direct investment has been access to developed economies with large and growing markets. Tax laws and investment incentives were found to be of secondary importance.

More recently, however, the proliferation of investment incentives and changes in U.S. tax law may have increased the importance of tax laws and investment incentives [9]. BEA's data show that U.S. parent companies are increasingly using holding company affiliates within their organizational structure. In 2004, investment in holding companies accounted for one-third of U.S. direct investment abroad, compared to 9 percent in 1982 [10]. These holding companies typically represent a new, intermediate layer of direct investment, created between the direct investor and its affiliates in manufacturing or other industries located in third countries. One of the reasons why MNCs use holding companies is to take advantage of favorable tax incentives. BEA's data do show a concentration of holding-company affiliates in developed and developing foreign countries where the income tax rate is relatively low.

*How do MNCs contribute to cross-border transfers of technology?*

One of the major concerns expressed about multinationals is that they erode the U.S. technological advantage either by U.S. companies transferring technology to their overseas investment partners or by foreign companies buying U.S. high-technology companies to gain access to U.S. technology and know how. Unfortunately, technology transfers are very hard to define and measure. Technology transfer may occur simply by an employee traveling to an overseas affiliate and discussing technology or through a series of E-mails rather than through an explicit royalty or licensing payment that would show up in companies' financial accounting statements or foreign direct investment operations reports.

By default, research has tended to focus on identifying and categorizing the U.S. industries in which foreign companies invest and how much they spend on research and development. As it turns out, they mainly invest in the same industries as their parents, and their investments are only slightly more concentrated in high-technology industries than those of all U.S. companies [11]. Research and development activity has grown faster within foreign-owned firms than in all U.S. firms, but this may simply reflect the propensity of these firms—like U.S. multinationals—to invest in more concentrated, more capital intensive, higher productivity, higher wage, and higher technology industries. Additional data development work by the National Science Foundation, the U.S. Census Bureau, and the Bureau of Economic Analysis may shed more light on this topic [12].

*How do multinationals affect trade flows and trade balances?*

Although multinationals' trade accounted for more than half of U.S. goods imports and over two-thirds of U.S. goods exports in 2003, it is not clear what the impact of overseas investment by multinationals is on total U.S. trade or the U.S. trade balance. Many would suggest that overseas investment expands the overall volume of trade and production rather than substituting foreign for domestic production. Indeed, the share of U.S. multinationals' total production occurring abroad shows no upward trend. BEA studies do, however, show that, although U.S. affiliates of foreign companies do purchase most intermediate inputs domestically, they are more reliant on imports than other U.S. firms [13]. In addition, some of the industries associated with large imports represent wholesaling operations in which affiliates were established to facilitate the distribution of goods produced by their foreign parent companies. In several cases, such affiliates have subsequently been replaced by, or have evolved into, manufacturing affiliates, which over time may progressively rely more on their own value added and on locally procured intermediate inputs, and less on imports from their foreign parents.

Another perspective on the contribution of multinationals to the U.S. economy can be seen by looking at BEA's supplemental ownership-based measures of the U.S. current account. These measures highlight the large overseas sales of U.S. and foreign companies and their relation to U.S. trade and investment income [14].

*Do MNCs invest abroad mainly to achieve efficiency in vertical integration, by locating different stages of production in different countries, or does their international expansion tend to be more horizontal in nature, with essentially identical processes replicated in multiple countries?*