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The U.S. Wants Manufacturing to Drive Growth. Foreign Friends Can Help

YUKA HAYASHI
PROGRESSIVE POLICY INSTITUTE

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INTRODUCTION

As the world grappled with shortages and soaring prices of energy and food following Russia's invasion of Ukraine in the spring of 2022, Treasury Secretary Janet Yellen introduced the term "friend-shoring" to describe a new dynamic needed for America's economic engagement with the world. She called for building and deepening integration among trusted partners to secure supplies of critical raw materials, technologies, and products.

"Let's do it with countries we know we can count on," she said in a Washington speech. "Favoring the 'friend-shoring' of supply chains to a large number of trusted countries, so we can continue to securely extend market access, will lower the risks to our economy, as well as to our trusted trade partners."[1]

Yet, when it comes to working with friendly partners seeking to invest in the U.S., Washington's message has been less than welcoming. Amid the rise of "America First" economic nationalism, its policies have been inconsistent and muddled, even for companies from the closest allies in Europe and East Asia. Election-year politics have further complicated its stance, casting in doubt the fate of a high-profile pursuit of U.S. Steel by Japan's top steel maker.

President Biden wants to strengthen American manufacturing. Foreign investors can help speed it up. They have for decades created more jobs, paid higher wages and spent more on factories and equipment than the average U.S. manufacturer. Their spending on research and development has enhanced productivity and accelerated America's strong innovation.

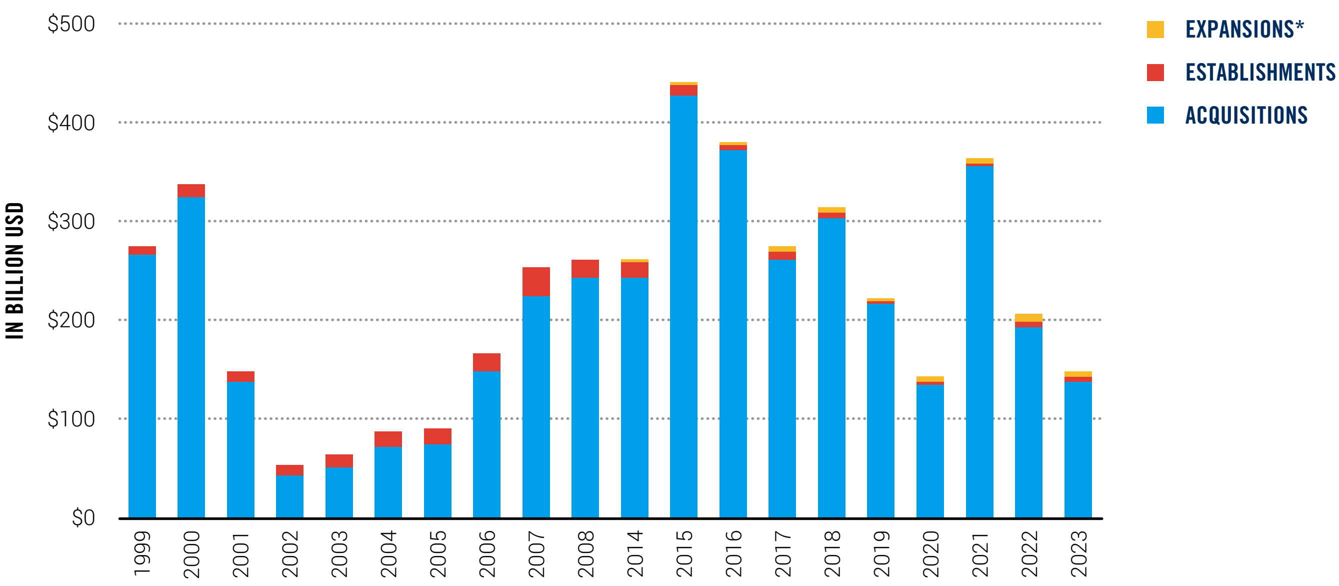
America's manufacturing is already starting to benefit as companies from allied nations take up Yellen's concept and "friend-shore" some of their production to the U.S. Amid growing U.S.-China tensions, South Korea's LG Energy is building an EV battery plant with Hyundai Motor in Georgia and another with Honda in Ohio, while BMW is adding EV assembly lines to its South Carolina plant. Multi-billion-dollar semiconductor factories are under construction by Samsung in Texas and Taiwan Semiconductor Manufacturing in Arizona.

Yet, after hitting a record $440 billion in 2015, annual flows of foreign direct investment into the U.S. fell sharply — declines economists attribute to technical changes in corporate accounting strategies, as well as a protectionist turn in U.S. trade policy brought by former President Trump.

The pandemic then further lowered inflows. Between 2016 and 2023, the annual value of FDI averaged $256 billion. Investment flows have been helped by Washington's efforts to bolster green technology and semiconductor manufacturing[2], but overall fell 28% in 2023 to $145 billion.

With the right set of policies, America can go a long way toward bolstering its domestic economy while strengthening its ties to close allies. To maintain strong alliances, the U.S. must not just talk, but show them it has their back.

FIGURE 1: NEW FDI IN THE U.S.



Data: Bureau of Economic Analysis

THE BENEFITS OF FOREIGN INVESTMENT

Foreign direct investment represents a relatively small share of the U.S. economic activity, but delivers a lot of bang for the buck.

Foreign companies that invest in U.S. businesses — classified by the Commerce Department as "majority-owned U.S. affiliates of foreign multinationals" — directly employed 7.9 million workers in 2021, accounting for 6.2% of the total private-industry jobs. They added $1.2 trillion to the U.S. gross domestic product, or 6.5% of total private-sector output, according to the most recent data from the Department's Bureau of Economic Analysis.[3]

By other measures, foreign investors punch way above their weight. They account for 17.3% of all private-sector spending on property, plant, and equipment, and 13.3% on research and development. They help expand U.S. exports, accounting for nearly a quarter of the country's overall exports.

In its 2022 report, the Commerce Department estimated FDI was responsible for more than 16 million jobs or 10.1% of all U.S. employment in 2019, when taking into account jobs created through productivity gains and ripple effects on supply chains and local communities.[4]

As one example, BP, the British oil company, operates some 8,000 gas and retail locations in the U.S. and employs 30,000 people, while Ahold Delhaize, a Dutch-Belgium retail giant, runs 1,108 grocery stores through chains like Giant and Food Lion. Toyota employs nearly 50,000 people in the U.S. and has built more than 34 million cars and trucks at its nine U.S. manufacturing plants.

Just as important for policymakers' consideration is the high pay many foreign manufacturers bring. In 2021, they paid their U.S. workers an average of $97,490 in compensation, including pension and insurance contributions, compared with $95,509 for all U.S. manufacturing employees, according to BEA data.[5]

In the chemical industry, which includes pharmaceutical firms, for example, foreign employers paid $148,885, compared with the industry average of $135,565. In food, beverage, and tobacco, the average at FDI firms came to $79,893, higher than $69,690 for all workers in the industry.

Midwestern states are among the biggest beneficiaries of foreign investments. Michigan, Ohio and Illinois were among the five states with the largest employment by foreign-affiliated manufacturers in 2021, according to BEA data. Michigan, for example, was home to 207,000 workers, the highest number after the 221,000 FDI employees in California — a state with four times Michigan's population and which is often seen as especially "globalized."

With nine out of 100 workers employed by foreign affiliates, Michigan — a key battleground state in this year's presidential election — has, in fact, seen its reliance on foreign employers grow. Between 2016 and 2021, the state's FDI employment grew by 28%, while its overall private-sector payroll shrank by 2.5%.[6] Driving the growth are companies like South Korea's LG Energy, which plans a $3 billion expansion to its Holland, Michigan plant to supply electric vehicle batteries to Toyota.

"Kaizen" Continues at Toyota

Japan, the U.S.' largest FDI investor since 2019, has poured nearly half of its investment into manufacturing. The sector remains a strong suit for Japan, generating 19% of Japanese domestic economic output in 2022. That's higher than America's 11%, though behind China's 28%, according to World Bank data.[7]

Despite the decline of the country's technology sector in recent decades, many Japanese manufacturers remain global leaders. Toyota and Honda cars account for six of the world's 10 best-selling vehicle models in 2023, according to MarkLines, a Japanese auto data provider.[8] Machine tool makers like Tokyo Electron play essential roles in global semiconductor manufacturing, while engineering corporations such as Mitsubishi Heavy Industries build parts and equipment for aircraft and power plants worldwide.

The auto sector leads Japanese investment in the U.S., accounting for more than half of the total Japanese manufacturing sales in the U.S. in 2021, according to BEA data. The companies started local production in the 1980s to dodge import quotas, as well as the negative impact of currency fluctuations. The expansion has been fueled by the popularity of their vehicles with high quality and competitive prices.

As Japanese automakers built new factories, they brought their efficient production processes, allowing them to keep costs down and product quality high. The best known is the Toyota Production System, designed to eliminate waste and shorten delivery time, and fortified by the concept of "kaizen," or making continuous incremental progress. The just-in-time system, invented by Toyota and later mimicked by others to minimize the inventories of materials and parts, came under criticism during the pandemic for exacerbating the shortage of vehicles and other products nationwide. Ironically, Toyota fared better than its American rivals thanks to a more diversified supply chain for semiconductors, a key item linked to product shortages. Toyota executives say the company had learned from its experience following the 2011 earthquake and tsunami in Japan, which disrupted semiconductor output and curbed auto production in the country.[9]

U.S. automakers have narrowed the quality gap with their foreign rivals in recent decades, and Tesla has beaten Japanese and other foreign competitors in electric vehicle sales. Still, when it comes to product quality, they remain laggards. None of their brands made the 10 most reliable names ranked by the Consumer Report last year. Six were Japanese, led by Lexus and Toyota. The U.S.'s six-decade-old 25% tariffs on imported light trucks have reduced foreign competition and protected domestic producers, encouraging the Detroit automakers to focus on the profitable pickup truck and large SUV segments. That left the market for small, fuel-efficient cars wide open for foreign companies and allowed them to dominate the huge market.

JAPAN, AND OHIO'S "SMOKESTACK CHASER"

For Japanese, German, and South Korean automakers, the United States is not only a lucrative market but also an attractive place to manufacture high-quality competitive vehicles. The foreign companies draw fire from unions and progressives, however, for locating many of their plants in the less union-friendly South. The critics have a point. Many Japanese companies have, in recent decades, chosen right-to-work states like Tennessee, Kentucky, and Texas. But the success of foreign automakers also raises uncomfortable questions about America's more confrontational relations between managers and workers and its impact on the quality and competitiveness of vehicles made by U.S. companies.

Foreign-owned firms have paid wages competitive to those at the Big Three, but they were free from the high pension and healthcare liabilities for older and retired union workers that for long weighed on the Detroit automakers' bottom lines. The cost gap persists today even after the Big Three significantly cut their legacy labor expenses.[10] The annual compensation, including healthcare and pension contributions, at foreign-owned auto industry companies was $81,094 in 2021, lower than the U.S. average of

$82,964, according to BEA data. That puts the sector outside the national trend where foreign-owned firms pay better than American-owned businesses, as we have examined.

Not all FDI flows to the South. Three especially union-friendly states - Ohio, Illinois and California - ranked among the top five states hosting Japanese foreign direct investment in 2021. In Ohio, Japan is by far the largest foreign investor, with nearly 70,000 people working for Japanese affiliates in 2021. (There is no shortage of irony in the fact that the most vocal critics of Nippon Steel's proposed acquisition of U.S. Steel include the two U.S. Senators from the state, Sherrod Brown, Democrat, and J.D. Vance, Republican.)

Japan's corporate presence in Ohio dates back to 1977 when Honda Motor chose the Columbus suburb of Marysville as the location for its first U.S. assembly plant. Driving the selection was James Rhodes, Ohio's then Republican governor with a reputation as a "smokestack chaser," for his fondness for luring factory investment.[11]

Rhodes had first met Honda founder Soichiro Honda during a late 1960s Japan visit. Thereafter, whenever the Japanese auto industry pioneer visited Ohio, Rhodes took him golfing. As Honda executives were choosing between his state and Tennessee, Rhodes sent them on a tour of industrial suburbs in a state-owned airplane. Once the Japanese said they liked a 217-acre plot near a main highway, Rhodes offered it for free. (Honda declined and paid for the land.)[12]

By establishing its factory as a non-union operation, Honda set a consequential example for Japanese and other foreign automakers that followed in its wake. Accustomed to a more cooperative relationship between the management and workers in Japan, Honda executives devised a management system where employees are called "associates" and purportedly are treated as equals. The United Auto Workers failed to organize the Honda workers — and it had to wait until this year to see its first representation at a foreign-owned plant when Volkswagen workers in Tennessee voted to join the union.[13]

In terms of creating good production jobs for U.S. workers, the efforts by Rhodes and early Honda executives have paid off. What started as a $25-million motorcycle plant with 64 workers in Marysville has grown into a cluster of five auto plants in the state with 15,000 workers with a total investment of $14.5 billion. Honda is now turning Ohio into its U.S. EV production hub, which includes a new $3.5-billion battery plant built jointly with South Korea's LG Energy.

"This is our time in history," Ohio Gov. Mike DeWine said last year at the groundbreaking of the new battery plant that brings 2,200 jobs to rural Fayette County. "We are going to continue to bring companies into Ohio. We are going to continue to see companies that are already in Ohio continue to expand."

Securing Pharmaceutical Supply Chains

While auto firms remain the top Japanese manufacturing investors in the U.S., other industries such as pharmaceuticals, food, and electronic products have also become prominent investors. As shown in the first paper of this research project, Japanese businesses have struggled to grow sales in Japan's shrinking and aging domestic market. Many companies previously focused on Japanese consumers have turned their attention overseas, particularly to the U.S.

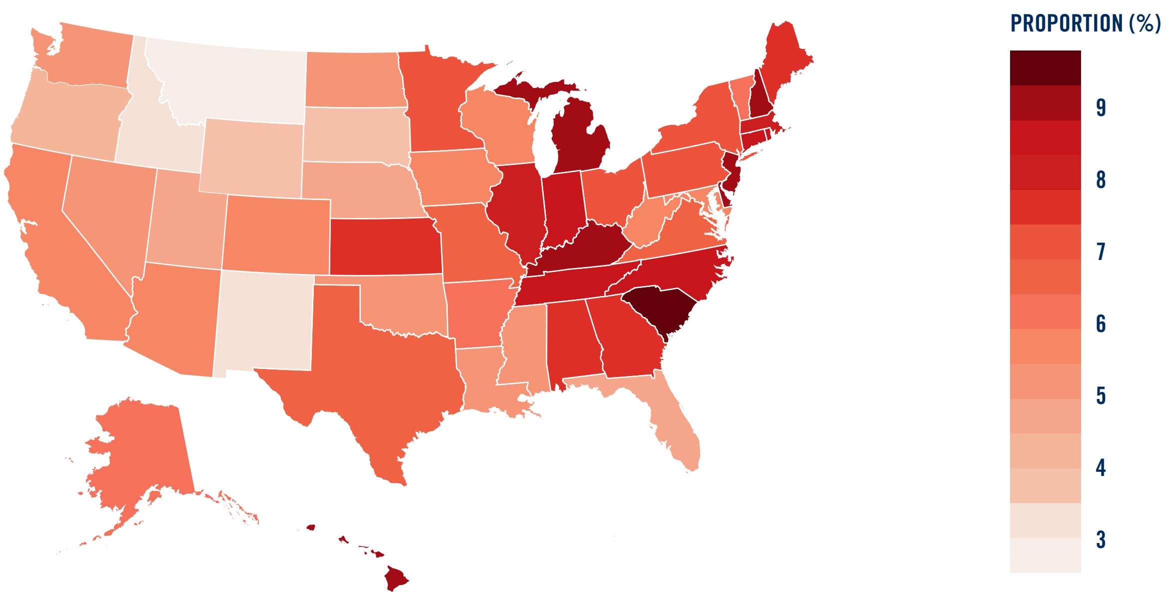
Japanese pharmaceutical companies, for example, employed 33,000 Americans in 2021 — more than triple their 2015 level. That number is expected to grow in coming years, thanks to investors like Fujifilm, a company that has made a dramatic shift to healthcare from the dwindling market for cameras and photographic film. As Prime Minister Fumio Kishida toured the U.S. in April to reaffirm strong bilateral ties, the company announced a plan to spend $3.2 billion on a new biopharmaceutical production plant in North Carolina, up from the $2 billion pledged in 2021. The Wake County facility will start making cancer and other antibody drugs under contract with major pharmaceutical companies next year.[14]

The facility is set to employ 1,400 people by 2031, including engineers and scientists. The average annual pay is estimated at $109,923, compared with the county average of $74,866. Altogether, North Carolina officials project the facility will add $4.7 billion to the state's economy over the coming 12 years.[15]

"We do not take these opportunities for granted because companies like this can choose to locate anywhere in the world," Governor Roy Cooper said as he unveiled the investment in April. "The goal of putting money into the pockets of North Carolina families requires foreign direct investment in our state." In the past decade, Japan has accounted for nearly half of foreign direct investment in North Carolina, making it by far the largest source of FDI.

The projects, such as Fujifilm's, could also help the U.S. strengthen the supply chains for pharmaceutical products — one of the key sectors for which Washington wants to reduce the country's reliance on Chinese imports. Citing concerns over the security of patient data, proposed legislation in Congress dubbed the BIOSECURE Act seeks to prohibit U.S. government agencies from purchasing products from "biotechnology companies of concern," including several major Chinese drug manufacturers.[16]

FIGURE 2: PROPORTION OF PRIVATE SECTOR EMPLOYMENT WORKING FOR FOREIGN U.S. AFFILIATES (2021)



Source: U.S. Bureau of Economic Analysis, Bureau of Labor Statistics

The Wake County facility will be a "tremendous asset for U.S. pandemic preparedness and securing United States supply chains," said Lars Petersen, chief executive of Fujifilm's biotechnologies unit.

Fujifilm is not the only foreign company that sees growth opportunities in U.S. biopharmaceutical manufacturing. Switzerland's Lonza in March agreed to a $1.2-billion purchase of a Genentech facility in California.

U.S. FDI POLICY AT A CROSSROADS

As Washington has forayed deeply into industrial policy to boost domestic manufacturing, it is facing thorny questions regarding which foreign partners should benefit from such programs, and how they should be treated vis-a-vis U.S.-based companies.

The sheer size of the Inflation Reduction Act — with an estimated price tag of $800 billion over the next decade[17] — has alarmed foreign governments, both allies and rivals, who are unable to match such spending. While praising the Biden government's pro-climate stance, European Union officials have complained that the IRA's subsidies and tax credits would divert new investments away from Europe to the U.S. China has filed a dispute at the World Trade Organization.[18]

The IRA's content requirements for EV batteries, in particular, rankled Japan and the EU because its consumer tax benefits were to be given only to Free Trade Agreement partners, which they are not. The U.S. has signed a pact to make Japan eligible, but negotiations with the EU continue more than two years after the law's enactment.

Foreign businesses now see both opportunities and hurdles. For example, of the 298 large Japanese manufacturers surveyed last year by the Japan Bank for International Cooperation, a government lender, 13% saw increased business opportunities due to the IRA, while 6.7% feared the opposite. Among 93 auto industry respondents, 18% saw diminished business prospects, higher than the 12% who looked to gain from the program.[19]

For the $53-billion CHIPS and Science Act, Washington's No. 1 goal is to increase domestic production of advanced chips to power everything from artificial intelligence to iPhones. The U.S. currently imports more than 90% of such chips from Taiwan Semiconductor Manufacturing. That, Commerce Secretary Gina Raimondo has warned, makes China's potential invasion of Taiwan and seizure of the company "absolutely devastating."

Yet, TSMC has not been the biggest beneficiary of the CHIPS Act. The U.S. awarded the company $6.6 billion in grants and $5.5 billion in loans for its new Phoenix plants, smaller than the $8.5 billion in grants and $11 billion in loans offered to Intel, the U.S. chip company that has lagged behind TSMC and South Korea's Samsung Electronics in making most advanced chips. The more generous award for Intel reflects larger investment amounts the company plans for expanding its capacity in the coming years.[20]

CFIUS GETS BUSY

As economic rivalry with China has intensified, the U.S. has increased its scrutiny of foreign investments. Its main tool is the Committee on Foreign Investment in the United States (CFIUS), an interagency committee established in 1975 to review inbound investments to determine national security risks.

While generally supporting the principle of non-discriminatory treatment of foreign investors, the U.S. has for decades boasted a more comprehensive system to review and sometimes restrict inbound investments than other rich democracies.[21]

Nippon Steel's 1983 attempt to acquire a division of Allegheny International was blocked by the Defense Department, citing the risk of technology leakage to the Soviet Union.[22] The 1988 Exon-Florio Amendment to the Defense Production Act — adopted in response to growing Japanese technology investments — authorized the president to probe foreign transactions using CFIUS and block those deemed harmful to national security.

As the tensions with China grew in recent years, former President Trump in 2018 signed a law expanding CFIUS's jurisdiction to real estate transactions. President Biden in 2022 issued an executive order to enhance scrutiny of investments from countries of concern such as China to prevent access to sensitive data.

CFIUS is busy. The committee reviewed a record 440 filings in 2022, up from 249 in 2018.[23] It has become more aggressive in mitigating proposed transactions by requesting changes to their deal structures. In 2022, a record 18% of investigated cases were subjected to mitigation.[24]

Still, presidential orders blocking transactions have been rare. Only eight such cases have occurred in history, with four announced during the Trump era. Nearly all involved a Chinese-owned company as the buyer. One exception was the 2018 prohibition of a hostile acquisition of Qualcomm by Singapore-domiciled Broadcom, denied based on concerns that foreign ownership would weaken Qualcomm's R&D prowess and allow Chinese rivals to expand their influence. President Biden has blocked one transaction — the purchase of a cryptocurrency mining facility near an air force base by a company majority-owned by Chinese nationals.[25]

The CFIUS has for months been scrutinizing the proposed acquisition of U.S. Steel by Nippon Steel, Japan's No.1 steel maker that has pledged billions of dollars in new investment to upgrade existing mills in the industrial Midwest. The media has reported that President Biden is nearing a decision to block the deal based on a recommendation from the CFIUS, which according to administration officials, found national security concerns. The collapse of the deal would represent the first use of the CFIUS process to kill a transaction with no clear linkage to China risks by a company from a close ally. Such an action might veer far from the CFIUS statute's central focus on national security risks and undermine the credibility of the committee at a time when it takes on a greater role to counter China's rise.

The failure of the Nippon Steel deal could be painted as an unfortunate case caught up in election-year politics in battleground states. But it would undeniably shake the confidence of foreign investors, particularly those from Japan. "We are very alarmed by any attempts to politicize," the CFIUS process, said the Japan-U.S. Business Council, a group representing Japan's largest companies, in a Sept. 5 statement. Underlining millions of jobs the bilateral business ties support, the group urged the U.S. government to continue with the CFIUS review "with rigor and impartiality."

CONCLUSION

Reorganizing global supply chains under the concept of friend-shoring must be done in ways that bring benefits to all trusted partners involved. The U.S. must invest in new locations overseas and expand some existing trading relations to reduce its reliance on China. America's allies and partners must be encouraged — and allowed — to do the same. That includes the partners forging closer economic ties with the U.S. through more trading and investments.

Policies to promote such investment would also help ease jitters among European and Japanese officials worried that their economies will lose out as Washington and Beijing sharpen their confrontation with protectionist trade measures and aggressive industrial policy.

President Biden has taken bold steps to strengthen the domestic economy and has emphasized his intention to work closely with friendly nations. But when it comes to implementing friend-shoring that includes foreign investments in the U.S., Washington's message has been half-hearted at best. As the U.S. updates its policies toward foreign investments, it urgently needs to make clear who is welcome, and who may not be, to come invest in America.

And, as this study has concluded, direct investments by foreign investors accelerate the growth of the U.S. economy through higher pay, capital spending, and research and development. Such investments tend to lead to well-paying jobs in rural and suburban communities in the Midwest and in the South. Much would be left on the table by a failure to welcome friendly nations eager to bring more factories and research labs to America's heartland. For policymakers seeking to take bold steps to strengthen the domestic economy, embracing investments from allied nations is an effective choice.

ABOUT THE AUTHOR

Yuka Hayashi is a senior fellow at the Progressive Policy Institute. She was a journalist at the Wall Street Journal for two decades, most recently covering U.S. trade and economic policy from Washington. Previously, she was a Journal correspondent in Tokyo, where she wrote about Japan's economy and East Asian geopolitics.

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PROGRESSIVE POLICY INSTITUTE
1919 M Street NW,
Suite 300,
Washington, DC 20036

Tel 202.525.3926
Fax 202.525.3941

info@ppionline.org
progressivepolicy.org