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AMERICAN INVESTMENT POLICY:

THE PROBLEMS OF US INVESTMENT IN THE EEC

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The problems of US investment in the EEC

Points from a talk before the chamber in Berlin

by Klaus-Heinrich Standke

The European Economic Community and the USA have about the same population totals. But although the gross product of the EEC is at present only 40% of that of the USA, the rate of productivity is increasing. From '58 to '64 the increase was 35% in Germany against 22% in the USA, 32% in Italy and Belgium, 30% in Holland, and 27% in France. It was this encouraging European improvement which has led many US companies to participate in the EEC during the last 8 yrs.

Again, the gradual abolition of internal EEC tariffs has led other US firms to get inside the EEC external tariff wall, though it must be pointed out that the full success of the Kennedy Round Gatt negotiations would greatly reduce this particular advantage.

What other inducements have played a part? The tax treatment of US subsidiaries in Europe can no longer be seriously considered as such an inducement. The European and US tax authorities have combined to make certain that tax regulations do not cause unfair competition, as was still the case a few yrs ago. Particular attention should be drawn to changes limiting the use of Switzerland and Lichtenstein as tax havens.

An alleged advantage to US investors has been claimed in some European circles as due to an unrealistic exchange rate favoring the US $. These circles have said that "the Americans with their over-valued dollar buy European firms for a song." Two obvious comments must be made: (1) even if there were a currency advantage, it automatically becomes a disadvantage when profits are changed into dollars or invested capital is re-transferred to the USA; (2) a devaluation of the dollar or a survaluation of the European currencies would immediately make European goods that much dearer on the world markets, thus causing more problems than does US investment. We must also note that any US firm investing in Europe is certain to take into account the probable stability of the national currency.

The problem of the capital markets

The European capital market played only a small role in US direct investments until '65, for two reasons:

(1) The differing strengths of the capital markets. — The total value of private and state security issues at the end of '62 was about $925,000 m in the USA, against $300,000 m in Western Europe. But during that yr, the EEC new issue total was almost double the '61 total, whereas the USA total fell slightly.

(2) Greater capital need in Europe. — The total of long-term investments in the EEC was $20,600 m in '61 against $10,000 m in the USA, for the obvious reason that many more European enterprises have capital too small for their needs, than is the case in the USA. Comparative figures show that (excluding banking and insurance) at the end of '61 at least 65% of working capital was the company's own in the USA, against 50% in France, 48% in Italy, and 40% in Germany. This European shortage of own working capital is not eased by Washington's measures, intended to reduce the US payments deficit, which have led US firms to seek money in the already strained European capital markets. The natural result would be higher interest.

In the meantime, the cost per hr of European labor, a few yrs ago significantly lower than in the USA, has risen considerably, though perceptibly lower than the American labor costs in terms of worker-hours. US investors when choosing a site for a plant within the EEC will note that labor costs vary from country to country, with the highest in Germany and the lowest, on average, in Italy.

Research and development is an important factor in US investment policy. US research in many lines is greatly favored by the size of US govt orders, which provide revenue from which research can be financed. In some cases, special research allowances are made. And the results of any research may prove to be decisive in other production programs. European govts do not place orders of comparable size. A recent OECD study shows that the USA spent $17,500 m on research and development in '62, while the European industrialized countries — UK, France, Holland, Belgium and Germany combined — spent only $4,360 m. There are at present 435,000 scientists and engineers engaged in research and development in the USA, and perhaps' more in the USSR. Only 147,000 are employed in the five European countries which were covered in the study. This research advantage leads some buyers of industrial shares to prefer to participate in US companies where huge research programs offer possibilities of great new developments, rather than in the more limited European companies.

This fear of the American lead in research and development has been one of the chief French arguments against US investment. They say that the US parent companies conduct nearly all their research in the USA, and that the technical staff in Europe do not share directly. While the US processing industry spent almost 3% of total sales on research and development in '63, their foreign subsidiaries spent only 1%. For this reason the German minister for scientific research, Dr Gerhard Stoltenberg, recently suggested in Brussels that the Americans should transfer a larger share of their research activity to their European subsidiaries.

The key reason for investment

The desire to develop a new market is nevertheless the determining factor in leading US businessmen to participate in the European Economic Community. Almost half of all US firms in Europe, on being asked their motives for EEC investment, gave this as the most important.

Professor Vernon of the Harvard Business School has outlined a trade investment cycle of which the most important phases are: (1) design and introduction of product in US market; (2) growing US exports; (3) an overseas market becomes sufficiently developed to support operations similar to those conducted at home; a foreign plant is erected; (4) increased US foreign direct investment in production; (5) declining US exports of finished items, sometimes with continued exports of components and parts, and sometimes with the import into the USA of competitive finished items produced abroad.

In conclusion we may quote Russell Eggers, a former American Rhodes Scholar who recently addressed a congress of European bankers in Oxford: "We may not know the UK as well as the British, the German market as well as the Germans, or the French economy as well as the French. But we do know the European market as well as, if not better than, all of them."