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FOREIGN INVESTMENT

The End of the American Challenge?

by Jacques Pelkmans, Florence*

"Fifteen years hence not Europe will be the third industrial power in the world, after the United States and the USSR, but American industry in Europe" Servan-Schreiber wrote 1967 in his "The American Challenge". Now those fifteen years are past. What has happened really?

During the second half of the 1960s a debate raged in the European Community over what had been christened "The American Challenge" to European business and European industrial integration. Many policy-makers, business leaders and economists subscribed to widespread concern over insufficient firm size, over a technology and a management gap and the lack of an appropriate European industrial policy to foster European business integration. These factors were thought to cause an exceptionally rapid rise in US-owned capital formation in the European Community and the ensuing European production of American firms. The Challenge has been popularized by Servan-Schreiber on the basis of the fast growth in the stock of American direct investments in the European Community (USDIEC) and high market shares in some high technology sectors. The author summed it all up in the conjecture "that, fifteen years hence, not Europe will be the third industrial power in the world, after the United States and the USSR, but *American industry in Europe*"¹.

Now that the fifteen years are past, many seem to think that the Challenge has reversed direction over the Atlantic Ocean in view of the rapidly increasing European production in the United States. Others are under the impression that USDIEC have shrunk to trivial importance and indeed turned into disinvestment.

Although both are too simplistic applications of the notion that the pendulum has swung the other way, it will become clear below that the American Challenge has come to an end. However, the absence of a Challenge neither implies the absence of US direct investments in the Community, nor their triviality.

Flows of US direct investment into the European Community consist of three components: capital

outflows over the US balance of payments from parent to EC subsidiary, plus reinvested earnings, plus borrowing outside the US. Since there are no geographically disaggregated data on direct investment-related non-US borrowing, or emissions for the purpose of USDIEC for the 1970s, the flows are defined as the sum of the first two components.

For 1971-1979, the flows of USDIEC for the EC (9) increased by a nominal 240 %, in real terms by 135 %, and adjusted for the fall of the dollar, by approximately 104 %². This compares with a nominal 185 % for the EC (6) plus UK for 1962-1970 (in this period Ireland and Denmark took only a very small share and can be ignored) and a real 150 % increase. In other words, USDIEC flows (as defined here) in the 1970s grew by approximately one third less than during the buoyant sixties, and this in real terms. Given the volatility of annual direct investment flows, it is more appropriate to measure in three year averages. For the EC (9) the three year average (1971/73 to 1977/79) increases by 98 % nominally, 21 % in real terms, and a little over 7 % when adjusted for dollar fluctuation³. This compares with a 60 % nominal and a 38 % real increase for the EC (6) plus UK over 1962/64 to 1968/70. It appears that the real increase of USDIEC flows in the 1970s is roughly one-fifth of the real increase in the 1960s. Nonetheless, it is noteworthy that these data seem to contradict a widespread feeling in the European Community that USDIEC have shrunk or occasionally amounted to disinvestment.

¹ J. J. Servan-Schreiber: *Le Défi Américain*, Paris 1967; italics in original; translation by this author.

² The fall of the dollar is calculated against the ECU (as it is a weighted average of national exchange rates). All USDIEC data from Survey of Current Business, unless explicitly stated. The absolute USDIEC (9) flows for 1979 are \$ 9,544 million (\$ 4,172 million for manufacturing); latest revision, idem, August 1981, Vol. 61/8.

³ For the three year average, the 1972-1978 change in the dollar/ECU rate has been used (13.6 %).

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One reason is readily at hand as the geographical composition of the flows has shifted in favour of the UK and Ireland. The EC (6) registers an increase of USDIEC three year average flows (1971/73 to 1977/79) of only 48 % nominally, which is approximately -25 % in real terms and even much less when adjusted for the slide of the dollar. A second reason can be found in the sectoral composition of the flows: whereas the EC (9) registered a real, exchange-rate adjusted increase of three year averages of 7 %, it is approximately -10 % in manufacturing, the difference largely being due to the oil (and gas) sectoral investments in the North Sea. These flows are heavily biased towards the UK and the Netherlands, with smaller sums to Germany and Denmark. In fact, the USDIEC flows to the EC (6) in manufacturing register a negative real growth (of three year averages) of approximately -50 % (!), compared with -25 % for overall USDIEC (6) in the 1970s and +23 % for overall USDIEC (6) in the 1960s⁴.

The composition of the flow is also of interest because one might expect the share of reinvested earnings to increase over time as the share of new US entrants in total USDIEC declines. For the EC (6) this can be clearly established: for the period 1962/64 to 1977/79, the three year average capital flow from US parents to EC (6) subsidiaries remains virtually constant in current dollars, whilst the three year average reinvested earnings increase nearly twenty-eight-fold, boosting the (three year average) ratio of reinvested earnings to capital flows from 0.17 to 4.58. The comparable ratio for the UK increases only from 1.08 to 1.69, partly because US direct investment in the UK in the early 1960s was, on average, older than on the continent, and partly because the UK enjoyed relatively large capital inflows from US parents in petroleum (the 1977/79 ratio of reinvested earnings to capital flows for the UK, without petroleum, is 2.57). The 1970s show a trend for USDIEC (9) capital flows to peter out although the trend may have reversed in 1980⁵.

⁴ Note that -50 % and -25 % are not adjusted (downwards) for dollar depreciation against EC (6) currencies. The order of magnitude for 1972-1978 is approximately 15-20 % (weighted) appreciation for these EC currencies. The country growth rates for all USDIEC, three year averages (1971-73 to 1977-79) are: BLEU: 106 %; France: -1 %; Fed. Rep. of Germany: -11 %; Netherlands: 275 % (a strong increase in oil and gas sector, especially 1979); Italy: 67 %; Denmark: 88 %; Ireland: 102 % (but for 1974-76 to 1977-79, as separate data for 1971-73 are not available); United Kingdom: 186 %. Source: Survey of Current Business, various issues; own calculations. These growth rates are not adjusted for local inflation and dollar depreciation.

⁵ For example, capital outflows from parents as a percentage of affiliates' reinvested earnings are, for overall USDIEC: 1974: 154 %; 1975: 118 %; 1978: 46 %; 1979: 8 %. For manufacturing only: 1974: 109 %; 1975: 47 %; 1978: 30 %. For 1979 the manufacturing ratio is negative due to a large capital outflow from Germany to US parents: without Germany, it is 8 %. However, in 1980 the overall USDIEC figure soars to 74 %, that of manufacturing even to 96 %; the first rise is not due to petroleum, as the corresponding capital flow is negative.

Does all this mean that the European Community has become a less attractive economy in which to invest for US firms? A thorough analysis of this question is beyond the scope of this paper, but the various indicators we can construct do not all point to an answer in the affirmative. The clearest evidence is the EC share in the world-wide stock of US direct investment, which fell from 41.3 % in 1971 to 33.7 % in 1979. To reconcile this decline with the flow-data is less simple as not all the necessary data are available. There is a long-term decline in the EC share of US capital outflows for direct investments: the three year averages are 40.2 % for 1962/64, 23.1 % for 1971/73 and 34.0 % for 1977/79. However, this downward trend is overcompensated by the rise in USDIEC reinvested earnings: when adding the two flow-components, the three year averages of the EC share are 32.6 % for 1962/64, 36.2 % for 1971/73 and 39.2 % for 1977/79. The explanation has to be looked for in a higher depreciation rate or a lower propensity to borrow in Europe or to float stock.

The attraction of the European Community for US investors should also be related to the unpromising macro-economic climate of sluggish growth and investment in the Community of the 1970s. To study this relation in more detail with the two-component flow, as defined above, may be very misleading as depreciation and borrowing could result in quite different absolute and/or growth figures. Fortunately, the US publishes capital expenditure (property, plant and equipment) data of its foreign affiliates that provide a more faithful picture of real investment activity. Perhaps surprisingly, the three year average EC share in world-wide US affiliates' capital expenditure has increased in the 1970s from 35.3 % (1971/73) to 40.7 % (1977/79). The contribution of USDIEC capital expenditure to domestic Community investment shows an uneven pattern. Table 1 juxtaposes the volume growth of fixed investment in the EC and its members France, Germany and the UK for 1973-1979 with the real, exchange rate adjusted, growth of actual capital expenditures of US affiliates in the EC. It will be observed that USDIEC capital expenditures, though registering substantial volatility, increase moderately over a seven year period. The increase is more than double the (poor) investment performance of the EC at large and is likely to have helped more than proportionally to sustain Community economic growth. But the country composition of the increase is telling: France suffers from a large fall in real USDIEC capital expenditures and Germany from a moderate decrease, while the UK has enjoyed over a doubling (with overall UK fixed investment stagnating over seven years). Table 1 shows that, in the years

Table 1
Volume Growth of Fixed Investment and Real Capital Expenditures by US Affiliates in the EC and in Selected Member Countries 1973-1979
 (annual percentage changes)

	European Community		France		Germany		United Kingdom	
	FIX INV ¹	CEUSAF ²	FIX INV	CEUSAF	FIX INV	CEUSAF	FIX INV	CEUSAF
1973	4.5	4.8	6.1	-2.9	0.2	-8.4	6.9	38.4
1974	-3.3	13	0.9	+6.8	-9.9	11.4	-2.9	3.6
1975	-4.8	-4.6	-3.2	-3	-4.2	-20.8	-0.7	10.9
1976	3.3	-10.8	3.8	-36.7	4.7	-10.7	0.7	5.4
1977	0.9	9.4	-0.7	+15.8	4.0	-6.8	-2.1	25.4
1978	2.8	-2.2	1.5	-10.6	6.3	16.9	1.5	-2
1979	3.8	10.7	2.5	8.7	8.7	16.8	-1.9	7.8
index								
1972=100	107	119	111	72	109	92	101	222

¹FIX INV = volume growth in % of fixed investment.

²CEUSAF = capital expenditures of US affiliates in EC or member country (in source sometimes called: property, plant and equipment expenditures).

The basis of CEUSAF data is in current dollars. To render them more or less comparable with volume data of FIX INV they have been converted into local currencies by adjusting the growth rates by the change, for that year, in the currency/dollar exchange rate (in %), as calculated from Eurostat data; for the EC, ECU has been used; the nominal growth rates thus calculated have been adjusted for local (or weighted EC average) inflation.

Sources: Survey of Current Business, various issues; European Economy, Nov. 1980, No. 7, Statistical Annex, various tables; own calculations.

1975/1976, a downward trendshift can be detected for both continental EC countries, which they have not (yet) been able to reverse.

Transatlantic Investments

Another twist to the conjecture that the EC has become less attractive for direct investors consists of pointing to the simultaneity of hesitant USDIEC with soaring EC direct investment in the US (ECDIUS). To some extent one can explain this as a trend towards global orientation of EC business as well as increasing competitiveness after reconstruction and a multinationalization biased towards Europe. An upward trend in ECDIUS can already be observed during the second half of the 1960s⁶. On the firm level it is likely to be related to competitive conduct among firms on both sides of the Atlantic within oligopolistic industries⁷. An additional partial explanation is the "undervaluation thesis" of Aliber⁸, saying that it is attractive to invest in assets of an economy with an undervalued currency in the light of expected capital gains once the undervaluation is corrected. Given the sudden, deep

⁶ Cf. H. Ekblom: European direct investments in the United States, in: Harvard Business Review, July/August 1973, Vol. 51/4.

⁷ The "rivalry" explanation is worked out and tested in: E. Graham: Transatlantic investment by multinational firms: a rivalistic phenomenon?, in: Journal of Post-Keynesian Economics, Fall 1978, Vol. 1/1.

⁸ Cf. R. Aliber: A theory of direct foreign investment, in: C. P. Kindleberger (ed.): The International Corporation, Cambridge, Mass., 1970.

dives the dollar has made in the previous decade, especially vis-à-vis the "snake"-currencies of the EC, one would expect an upsurge of ECDIUS flows (and possibly even in stocks) that would fizzle out upon dollar appreciation. At the same time, however, firms tend to respond to expected exchange rate changes of some size by altering the time-structure of the capital flows between parent and subsidiary (the direction may even temporarily reverse) as well as the mode of entry or expansion in the market (in order to profit from "undervaluation" of the dollar, acquisition is more attractive than new, "green field" investments).

The Aliber thesis can possibly explain surges of unilaterally directed investment flows, but it cannot explain heavy two-way investment activity over the Atlantic. It also seems impossible to relate it to the sectoral composition of direct investment. Neither can the country composition be fully explained by undervaluation.

Internationale Kooperation

Aachener Studien zur internationalen technisch-wirtschaftlichen Zusammenarbeit – Eine Schriftenreihe des Forschungsinstituts für Internationale Technisch-Wirtschaftliche Zusammenarbeit der Rheinisch-Westfälischen Technischen Hochschule Aachen
 Hrsg. von Werner Gocht und Hubertus Seifert

Klaus Dieter Wolf

Band 21

Die Dritte Seerechtskonferenz der Vereinten Nationen

Die auf verschiedenen internationalen Verhandlungsformen ausgeprägte Auseinandersetzung um eine Reform der internationalen Ordnung mit dem Ziel größerer internationaler Verteilungsgerechtigkeit befindet sich auf UNCLOS III in ihrem fortgeschrittensten Stadium. Hier zeigt sich daher besonders deutlich, wie weit sich eine dem Gemeinwohl verpflichtete Rhetorik und tatsächliches Verhalten im Verhandlungsprozeß mit zunehmender Konkretisierung des Verhandlungsgegenstandes bei den Teilnehmerstaaten unterscheiden. Dem Autor, selbst seit mehreren Jahren Teilnehmer dieser Konferenz, geht es in seiner Untersuchung insbesondere darum, einen Einblick in die Veränderungsbedingungen des Verhältnisses zwischen Industrie- und Entwicklungsländern, aber auch zwischen den in der Gruppe der 77 zusammengeschlossenen Staaten der Dritten Welt untereinander zu geben.

Das wichtigste dabei gewonnene Ergebnis ist der Nachweis, daß sich das auf UNCLOS III vollzogene Aufbrechen traditioneller Konfliktstrukturen im internationalen System durch neuartige Bündnis-konstellationen nicht an der Wahrung globaler Gemeinschaftsinteressen orientiert, sondern an der Durchsetzung unterschiedlicher Sonderinteressen.

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Table 2
EC Direct Investment in the US as a Share of
US Direct Investment in the EC : 1966; 1974-1980
(Flows)
 (in %)

	EC ¹		France		FR Germany		Netherlands		United Kingdom	
	CO ²	CORE ³	CO	CORE	CO	CORE	CO	CORE	CO	CORE
1966	6	16	9	10	5	6	12	55	6	22
1974	63	50	65	58	258 ^a	95 ^a	92	71	22	29
1975	41	47	41	29	neg. ^b	neg. ^b	neg. ^c	1,159	35	47
1976	59	50	neg. ^c	331	131	38	262	217	25	37
1977	45	45	196	171	56	65	450	132	24	24
1978	99	54	44	21	519	41	neg. ^c	294	39	37
1979	657	76	77	39	neg. ^c	281	152	154	2,575	55
1980	45	51	74	29	neg. ^b	neg. ^b	238	342	40	34

¹EC in 1966 is understood to be the EC (6), plus the UK.

²CO = capital outflows from parent to subsidiaries.

³CORE = CO plus reinvested earnings.

^aData, based on the 1974 Benchmark Survey (on Foreign Direct Investment in the US) suppressed; data, taken from series based on the 1959 Benchmark Survey sample (implies underestimate of German flows to US in 1974).

^bFlow to US is negative.

^cFlow to EC is negative.

Source: Survey of Current Business, various issues.

Table 3
EC Direct Investment in the US as a Share of
US Direct Investment in the EC : 1966;
1974-1980 (bookvalues)
 (in %)

	EC ¹	France	FRG	Neth.	UK
1966	37	12	8	163	51
1974	40	23	19	144	46
1975	40	24	16	161	45
1976	38	26	20	164	36
1977	42	30	23	193	37
1978	43	29	25	210	36
1979	49	29	42	183	42
1980	49	20	34	203	40

¹EC in 1966 is understood to be the EC (6) plus the UK.

Source: Survey of Current Business, various issues.

Tables 2 and 3 reflect an attempt to come to grips with the conjecture of the Community's decreased attractiveness for Atlantic investors. Country fluctuations of the share of ECDIUS flows in USDIEC flows are sometimes very sharp because *both* US investors in the EC and EC investors in the US react to exchange rate gyrations. There is dramatic evidence of an exchange rate induced surge of ECDIUS flows during 1978 and 1979 (when the dollar fell sharply against the Pound and the "snake"), even leading to a 6-point rise in the Atlantic bookvalue ratio in one year⁹. The German reaction, especially, is extraordinary, tripling the capital outflow plus reinvested earnings from 1978 to 1979 thereby causing a 78 % increase in the bookvalue of its US subsidiaries.

But what is perhaps equally surprising is the evidence that American direct investments in the EC are still much

larger than ECDIUS. The bookvalue ratio has risen considerably since 1966, yet USDIEC in 1980 amounts to double the value of ECDIUS. The structural value for the ratio of flows, exchange rate gyrations apart, is around 50 % for the EC of the 1970s. In the second half of the 1970s new ("green field") investments of US investors have practically dried up¹⁰ – USDIEC nowadays consists virtually entirely of expansions of existing plants and acquisitions – but one should also realize that acquisition is *the* outstanding mode of expansion of ECDIUS, usually via EC affiliates already operating in the US¹¹. Hence, Tables 1-3 show that the idea that the European Community has become a less attractive place to invest relative to the US is not altogether reflected in the statistics: in Table 1 USDIEC shows a mixed comparative performance, while in Tables 2 and 3 USDIEC appears much stronger still than ECDIUS.

If one suspects the "relative attraction" thesis to be linked in some way with the decline of jobs in the EC, a much more thorough analysis is necessary. In such an analysis one would have to study in detail the consequences of the modes of direct investment and the sectoral composition. As to the latter it is noteworthy to observe that the share of manufacturing in USDIEC bookvalues decreased from 58 % (1977) to 54 % (1980), with petroleum falling from 24 % (1977) to 22 % (1980); yet, also the manufacturing share of ECDIUS fell from 39 % (1977) to 32 % (1980), with petroleum up from 23 % (1977) to 26 % (1980). Finally there are signs that the rate of USDIEC disinvestment has increased substantially during the 1970s, with Belgium taking the lead¹². It is important to establish to what extent disinvestment can be attributed to recessionary demand, or more elusive elements of the investment climate, and to what extent it merely results as the logical final stage of an earlier locational decision in the product cycle.

⁹ Concentrating on ECDIUS only, the bookvalue jumped from \$20,113 million (1977) to \$23,887 million (1978; +18.8 %), to \$32,349 million (1979; +35.4 %), while the capital flow plus reinvested earnings soared from \$2,409 million (1977) to \$3,846 million (1978; +59.7 %), to \$7,248 million (1979; +88.5 %!).

¹⁰ Cf. OECD: Recent International Direct Investment Trends, Paris 1981, p. 32.

¹¹ For example, over 1979 and 1980 together, ECDIUS consisted of acquisitions for 93 % of total outlays necessary for investment. Calculated from: Survey of Current Business, Aug. 1981, Vol. 61/8, p. 62.

¹² Cf. D. Van Den Bulcke: Investment and disinvestment policies of multinational corporations in Europe, in: D. Van Den Bulcke et al., idem, Westmead, 1979; J. Chopra, J. Boddewyn, R. Torneden: US Foreign Disinvestment: a 1972-1975 Updating, in: Columbia Journal of World Business, Spring 1978, Vol. XIII/1; Le Défi Américain wanes in Belgium, in: The Economist, Oct. 18, 1980, pp. 104-5. For recent data, but not disaggregated as to EC, cf. Survey of Current Business, Aug. 1979, Vol. 59/8, p.19; idem, Aug. 1981, Vol. 61/8, p. 24.

Stocks, defined as bookvalues, of USDIEC for 1971 and 1979 are presented in Table 4. The stock of USDIEC (9) increased, in nominal value terms, by 186 %, in real terms by approximately 80 %. The EC (6) has a similar growth rate. These growth rates compare unfavourably with the preceding decade: nominal growth of USDIEC (6) between 1961 and 1970 is 279 % (real, approximately 242 %) with 125 % nominal for the UK. The highest country growth rate can be found for Ireland, which has been very successful in attracting (not only) US investors during the 1970s, although Dutch growth is high as well. Italy has the lowest growth rate, with modest rates also for Germany and France. For the latter two the real growth rates, corrected for dollar depreciation, are 50 % and 27 % respectively. In the Italian case, one has to correct for a much higher inflation (roughly 195 %) and a compensating appreciation of the dollar vis-à-vis the Lira (close to 40 %), leaving a negative growth of the overall stock of US Italian direct investment¹³.

In manufacturing the growth of stock of EC (6) is above that of EC (9), due to the deplorable performance

¹³ Note that the 1980 nominal additions to the stocks, in current dollars, are highest for Italy (23.2 %), Ireland (24 %) and the United Kingdom (23 %).

of the UK (without the hike in 1979 the UK growth rate would have been even lower). A remarkable figure is that of Belgium where complaints about disinvestment have been heard most (the explanation is a high acquisition rate). Italy's stock in manufacturing keeps up better than the total US stock in the country: its positive growth is about one-quarter.

Other data on the economic activity flowing from USDIEC is scarcer. Value added data is not available beyond 1970, while total assets and total employment of USDIEC are available only for 1977¹⁴.

Waned American Challenge

The decline in the growth rates of annual additions to USDIEC, and in the growth rate of bookvalues, compared to those in the mid-sixties, are clear evidence of the waned American Challenge. But it is certainly not correct to think in terms of an Atlantic reversal: American production in the European Community has remained remarkably resilient and outweighs by far the Community's production in the US.

¹⁴ Survey of Current Business, April 1981, Vol. 61/4, gives assets for 1977 (Benchmark Survey, first results): \$ 164,950 million for the EC (9). Employment in 1977 is 2,668,914 employees. The survey is for non-banks only.

Table 4
Stock of US Direct Investments in the European Communities: 1971-1979
(millions of US dollars; percentages)

		1971	1972	1973	1974	1975	1976	1977	1978	1979	'71-'79
Eur. Comm. (9)	all	22970 ^a	25681 ^a	31257	35453	39081	44016	47933	55283	65681	+ 186 %
	manu.	13918 ^a	15606 ^a	18962	21214	22903	25121	27747	32150	35739	+ 157 %
EC (6)	all	13605	15720	19294	21755	23779	26656	28547	32484	39226	+ 188 %
	manu.	8381	9755	11736	13339	14633	16467	17806	20730	22851	+ 173 %
BLEU	all	1826	2143	2514	2945	3306	3607	4322	4739	6390	+ 250 %
	manu.	1015	1182	1376	1829	2013	2221	2607	2843	3375	+ 233 %
France	all	3020	3443	4259	4902	5743	5924	6090	6772	8024	+ 166 %
	manu.	2174	2493	3064	3428	3859	3968	4139	4686	5128	+ 136 %
Germany	all	5209	6260	7954	7971	8726	10410	11071	12746	13521	+ 160 %
	manu.	3295	3855	4666	4814	5353	6638	7031	8277	8575	+ 160 %
Italy	all	1871	1989	2301	2680	2679	2944	3016	3571	4381	+ 134 %
	manu.	1014	1173	1414	1688	1719	1870	1983	2406	2818	+ 178 %
Neth.	all	1679	1885	2266	3257	3325	3771	4048	4656	6910	+ 312 %
	manu.	882	1052	1216	1580	1690	1770	2046	2518	2955	+ 235 %
Denmark	all	358	379	847 ^b	688	631	735	730	857	1117	+ 212 %
	manu.	66	66	400 ^b	87	106	140	137	159	182	+ 176 %
Ireland	all	n. s.	n. s.	n. s.	472	664	897	1222	1593	1798	+ 281 % ^c
	manu.	n. s.	n. s.	n. s.	417	563	738	955	1271	1281	+ 207 % ^c
United Kingdom	all	9007	9582	11115	12537	13927	15696	17434	20348	23539	+ 161 %
	manu.	5471	5851	6827	7371	7601	7776	8849	9990	11425	+ 109 %

Notes: Stocks are defined as bookvalues; manu. = manufactures; ^a without Ireland; ^b includes Ireland; ^c 1974 to 1979; n. s. = not specified.

Sources: Survey of Current Business, various issues; 1979 data taken from the revision based on the 1977 Benchmark Survey sample.