Statement of

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Before the
Senate Committee on Interstate & Foreign Commerce

May 10, 1960

Mr. Chairman:

My name is George W. Ball. I am a member of the law firm of Cleary, Gottlieb, Steen and Ball. I feel I should make it clear to this Committee that, although my firm acts as legal counsel in the United States to the European Economic Commission, which is the executive body of the European Common Market, I appear here today as a private American citizen. The opinions I shall express to the Committee are my own and should not be regarded as reflecting the opinions of the Commission.

I have been asked to testify as to the implications of the European Common Market and the European Free Trade Association for our foreign trade and domestic economy. I understand that the Committee is particularly interested in exploring the consequences of one trend which the creation of those regional groupings is stimulating - the direct investment by United States firms in production facilities in Europe.

I have made no systematic study of this question. The Committee may, however, be interested in some observations derived from our professional experience in advising the managements of American companies regarding their European investment problems. I shall direct these observations at three questions:

First, the factors that are persuading American industrial firms to establish production facilities in Europe;

Second, the forms which those investments are taking and are likely to take in the future; and

Third, the implications of this investment trend for American business and labor and the American economy as a whole.

Why American Firms Are Investing in Europe

The decision by a corporate management to establish or develop production facilities abroad is normally influenced by a combination of considerations - not always articulated or fully understood even by the management. The relative weight of the individual elements that contribute to such decisions varies widely from situation to situation. Nevertheless, I think we can isolate some of the principal motivations for the growing trend toward direct investment in Europe.

By far the most compelling reason why an American industrial company should produce in Europe is that the European economy is growing at a substantially faster rate than our domestic economy. This high rate of growth began to develop momentum during the last decade. Within the past two years, the creation of the Common Market has provided an additional impetus. It is offering European producers for the first time the promise of a new mass market, with all the possibilities which that implies for the improvement of production, the elimination or absorption of marginal producers, the modernization of production and distribution techniques, and a full realization of the economies of scale.

Is it surprising, therefore, that the Common Market has become a magnet for American industry? It offers our more enterprising industrialists the challenge of a new economic frontier - the coming into being of a market serving a population approximately that of the United States market, in which the Gross National Product per capita has increased 50% in the last decade while our per capita Gross National Product was increasing only 33%. It is a market capable of enormous expansion, where the standard of living is still far lower than in the United States but where the mass of the population is beginning for the first time to want and expect the more elaborate types of consumer goods.

Granted all this, however, one may ask why American industry should not be content to serve this market by exports from the United States - why it is necessary for American firms to go to the market to establish production facilities.

Obviously many American firms plan, in fact, to supply this market by an increase in their export trade. This is particularly true where a product required by European consumers is identical with the same product now produced for Americans, and especially where that product is not labor-intensive. In such a case, production at home may involve merely a small addition to the total production on existing assembly lines. The resulting economy may be so substantial as to overcome any cost advantage enjoyed by European producers.

But for many types of goods this will not be the case.

A product may need a special design to meet the special requirements of the European market, or different designs may be needed for different segments of that market. In that case it will probably be cheaper to fabricate the product by using small-scale facilities in Europe than under the mass production methods of America. For other products, transport may be a major element of cost; in that case also it is obviously desirable that production be undertaken near the marketplace. Or Europe may offer advantages in the availability of raw materials or of components or in other elements of cost. In addition, there may be significant institutional factors, involving consumer tastes, or the need to adhere to an indigenous set of business practices. Not only may the company find it desirable to be identified with the community which it undertakes to serve but, in fact, it may greatly benefit from the established facilities, reputation and government relations of a European partner.

There is also the possibility that the American firm can improve its know-how and techniques by acquiring a production source in Europe. Europe today is alive with new techniques and processes and, by the creation of European producing subsidiaries. American firms can frequently practice a cross-fertilization of ideas.

You will note that I have failed to mention two elements upon which great emphasis has recently been placed. These are, first, the feeling that American-produced goods will not be able to compete effectively with goods produced within the Common Market because of the cost differential created by the common external tariff; and, secondly, the desire of American firms to take advantage of lower wage costs in Europe.

In my opinion the first of these elements - fear that the tariff provisions of the European Common Market will make United States exports non-competitive - has been overstated. During the entire postwar era, American exports have been subject to discrimination under systems of quantitative restrictions set up to safeguard the balance of payments of individual European countries. With the advent of liberalization and free convertibility, those restrictions are rapidly disappearing. Certainly any tariff disadvantage which American exports may suffer under the Common Market Treaty will be of a far less serious order than has been the case under quantitative restrictions. And I am confident that, if we conduct our own commercial policies sensibly, even this element of trade disadvantage can be diminished.

I am sure that the Committee is fully aware of the recent proposals of the European Economic Commission - the so-called Hallstein proposals - for accelerating the coming into being of the Common Market. Those proposals include the provision for a 20% across-the-board cut in the common external tariff on industrial products. The Hallstein proposals are being considered this very day by the Council of Ministers of the European Economic Community, which is meeting in Brussels. The proposals are, I think, unmistakable evidence of the determination of the Community to pursue a liberal course. I am convinced that the European Common Market is already proving an impressive force in the direction of a more liberal trade policy throughout the whole Free World.

The other element which has, I believe, been unduly emphasized, is the feeling that American firms are being led to invest in Europe in order to take advantage of low European wage costs. It is well known that wage costs are only one factor of cost, a cost factor that may be, and, in a number of cases, is, offset by higher raw material, capital, power and other components of cost. Even in those instances where lower wage costs have yielded lower unit costs of production, it has been my observation that most companies have regarded this as only a subsidiary consideration which tends to compensate for certain of the disadvantages of overseas production. Moreover, I think there has been considerable exaggeration as to what wage differentials in Western Europe actually mean. Statistical comparisons are difficult because of the fact that a high percentage - approaching thirty to forty percent - of the wage bill in some European countries is attributable to fringe benefits. But in any event, I think it is fair to say that the differential in wage costs is steadily shrinking.

Wages are not a static cost factor. Economic growth and heightened expectations are bringing new pressure for wage increases. A drying up of the fugitive labor from Eastern Germany; the creation of conditions of full employment, even over-employment, throughout most areas of the Community; the development of a more confident and more aggressive labor movement - these factors are all contributing to labor's demand for a larger share of revenues. And you must add to that the influence of the Common Market Treaty itself. By requiring the equalization of conditions of labor, the Treaty will tend to raise the wage bill in the lower income areas of the Community.

Whatever, therefore, may be the temporary advantage in labor costs enjoyed by producers within the Common Market, that advantage will progressively disappear if Europe continues its present rapid growth. American producers, in my observation, are aware of this. They are, for the most part, not basing their investment plans for Europe on the continuance of a labor cost advantage. They are investing for the long pull in reliance on the continued economic growth which will almost inevitably wipe out that advantage.

I would sum up by suggesting, therefore, that the establishment of production facilities in Europe is a normal and natural movement by American industry seeking a closer point for attack on a new and promising market. American industrial firms are building and buying factories in Europe today for the same reason that, during the postwar period, they have been building factories and developing facilities in Canada and in the west and southwest sections of the United States - because Canada and California and Texas and the whole West and Southwest have been developing faster than the traditional markets of the eastern parts of our country.

In a word, I would suggest that the construction of American production facilities in Europe is much more analogous to the recent trend toward establishing production facilities in the West than to the phenomenon of New England plants running away to the South in order to exploit a lower wage-cost area.

Form of Direct Investment in Europe

In the era of the so-called dollar shortage, when individual European countries were surrounded by a wall of quota restrictions, American firms were faced with a serious dilemma. They found it necessary to produce behind that wall in order to be able to sell to soft currency markets; they did not, however, find the climate propitious for long-term investment since they had no confidence in either the economic or political stability of many European countries. They, therefore, sought ways of participating in production on a basis of limited liability and with the hope of short-term profit.

Now the situation is altogether different. The American industrial community believes that the nations of Western Europe, particularly those included in the Common Market and the Free Trade Association, are politically and economically stable. In fact, there is evidence based on recent experience that the Common Market countries are certainly as stable and may be economically more stable than even the United States.

United States industrial firms are, therefore, undertaking forms of direct investment different from those they undertook ten years ago. Instead of patent and licensing arrangements, they are, for the most part, much more interested in the whole or partial ownership of production facilities. Firms with a limited commitment in production are increasing that commitment. In many cases firms which have never before done any substantial business, or even any business at all, in Europe, are now seeking partners or facilities in Western Europe with commendable resolution and self-assurance.

The course of this investment activity serves, I think, as added proof of the thesis I put forth a moment ago, that it is not the fear of tariff or quota disadvantages or the attraction of low wage rates which leads American industry to establish production facilities abroad. It is economic growth and a promise of continued growth. The low wages and the trade restrictions that prevailed in Europe during the first decade following the War were expressions of the poverty of the European economy. Poverty did not attract American investment, nor will it ever do so. The investment flow began in impressive volume only when a surge of economic growth had begun to eliminate low wage levels and trade restrictions.

But even the present high level of investment in the Common Market does not mean that large amounts of American capital are moving from the United States to Europe. For the most part American companies are concentrating on establishing beachheads of production; they are limiting their capital investments. In 1957, for example, according to Department of Commerce figures, only 19% of United States direct foreign investment in Europe consisted of capital exported from this country. Of the balance, 35% came from funds obtained in Europe, and the remaining 46% was principally out of reinvested earnings and depreciation and depletion. In 1958 this situation was even more pronounced. Only 8% of total direct investment in Europe was represented by the export of United States capital, while 44% represented funds obtained in Europe.

I think it likely that a second wave of American direct investment in Europe will occur two or three years from now - a wave of greater dimensions than any we have seen up to this point. If American firms find Europe a profitable place to do business - as has been their common experience in the last two or three years - they will seek to expand their existing facilities. They will have gained experience and, with experience, the confidence and sense of assurance that conduce to expansion.

But it is probable that this second wave will be financed to an even greater extent with funds found in Europe. Today many European subsidiaries of American corporations are obtaining capital from local partners and by limited borrowings from European financial institutions. But in many cases the capital structure of these subsidiaries precludes a full resort to local financing. European financial institutions are reluctant to lend money to American subsidiaries which have only a small equity in relation to debt, when they do not know the parent companies as well as they know established European firms.

This situation will not always prevail. As earnings are accumulated and reinvested, as American companies consolidate their relations with European banks and financial institutions, American firms doing business in Europe will find it increasingly attractive to raise their money on the European capital market. This will most certainly be true if interest rates continue to decline in Europe while they rise in the United States.

Implications of American Direct Investment in Europe

As the Committee well knows, the trend toward the increased development by United States firms of production facilities in Europe has often been viewed with alarm. First, the fear has been expressed that the trend would lead to a drying up of United States exports, which would, in turn, contribute to unemployment at home. Second, there has been concern that direct investment abroad would exacerbate the troublesome United States balance-of-payments position.

I do not regard either fear as well-founded.

Direct Investment and U.S. Exports

The decline of United States exports between 1956 and 1959 was due largely to a shrinkage in shipments of cotton, petroleum, iron and steel, metal products, aircraft and non-ferrous metals. The decline in those exports cannot be attributed to the growth of United States investment abroad. On the other hand, the liberalization of quota restrictions, which has come about with the recent advent of prosperity and convertibility in Europe, has opened up greater markets for United States products, while the growth of the European economy has materially increased demand, particularly for our capital goods. In the first two months of this year, for example, United States exports to the Common Market amounted to almost $550 million, or 52% above the same period in 1959, and 36% above the same period in 1956, to which we tend to look back nostalgically as a "normal" period. The reason for this increase in exports is, of course, the phenomenal growth of investment and per capita income in Western Europe, to which the Common Market is making a significant contribution.

Similarly, the developments in our import trade have not been attributable to developments in United States foreign investments. If automobiles are left out of the picture - and they are a very special case, since the import trade in automobiles developed almost entirely from the refusal of the American automobile producers to make a type of car the public wanted - the increase in our imports has gone hand-in-hand with the increase in our Gross National Product; total imports have remained a stable proportion of our GNP - 3%. One of the factors in explaining the stable pattern of our import growth has been the stability of consumer disposable income in the United States in spite of the business cycle fluctuations; exports, on the other hand, have been sensitive to cyclical factors.

Direct Investment and the U.S. Balance-of-Payments Position

Nor is it true that private direct investment in Europe has had an adverse effect on our balance-of-payments position.

First, every year since the end of World War II, and even before, the United States has been a net recipient of payments from the rest of the world on direct private investment account. By this I mean that income from such investments has exceeded the outflow of new investment capital. During the period from the beginning of 1956 through the first three-quarters of 1959, for example, this excess of income over outflow aggregated more than two billion dollars - which operated to support, rather than weaken, our balance-of-payments position.

Second, even were this not the case, it could not be argued that our balance-of-payments problem of 1958 and 1959 was caused by an increased outflow of direct private foreign investment; the outflow was actually less during those two years than in 1956 and 1957, when our deficit was substantially smaller.

Third, as I have pointed out earlier, there is no vast movement of United States capital into Europe today in the form of direct investment. The greater part of our new direct investment in Europe is being financed either through the retention of income earned in Europe or through European financial sources. We are thus building up the total net asset position of American firms, with no drain on our own capital market. The future income from those assets should serve as a stabilizing factor for our total economy.

Fourth, a fair part of the United States capital which has gone to Europe has not been invested in new production facilities but has instead been used to acquire a share in existing facilities.

Conclusion

I do not mean to suggest by these observations that the present trend toward investment by United States firms in production facilities in Europe will be without effect on the shape and character of our foreign trade or even of our domestic economy. Investment necessarily means changes in production as well as in trade patterns. Some American firms may begin to produce goods in Europe which they are now exporting to European markets. They may even begin to serve third markets by exporting from their European factories the same kinds of goods that they now produce in America. Some categories of United States exports will consequently suffer, but others will benefit.

In some industrial sectors European subsidiaries of American companies may even export to the United States in competition with U.S.-produced goods. But, except in a relatively few industries, I think it highly unlikely that such a practice will develop in substantial volume for many years to come.

Already we are beginning to see signs of the building up of a reciprocal investment flow. Some European capital is coming into the United States and finding its way into production facilities, under the direct management of European companies. This counter-trend is likely to increase if, as I hope, our own rate of growth is speeded up so that it more nearly approaches the rate of growth in Europe today. But in any event, I see no cause for alarm about the rate with which United States firms are seeking European production facilities. I think it is clear, as I have tried to show, that this offers no menace either to our merchandise trade or our over-all balance-of-payments. On the contrary, growth in Europe will, I am fully persuaded, be a real stimulant to American exports, for the lesson of history is that we export most to countries with the highest standards of living and to countries in which we have our largest investments.

In the Interim Staff Report to your Committee, the point has been quite properly made that for us to reduce the flow of private investment abroad would be inconsistent with our position of moral and political leadership in the world. It would also, I think, interrupt an historic process which is altogether healthy. Just as we have seen the expansion of United States firms from regional to nation-wide production, we are now witnessing the beginning of their expansion from nation-wide to world-wide production. Many of our industrial firms have in the past shown a parochial attitude toward world trade. They have been content to concentrate on the expanding domestic market, leaving their foreign business to be done by an export or foreign department, which they have regarded as a rather uninteresting step-child. But as this country has expanded its political responsibilities to embrace a great part of the world, so American industry must expand its own horizons of production and trade. What we are witnessing today, as American firms acquire production facilities in Europe, is the classic pursuit of a normal, healthy, economic motive of seeking to exploit a new mass market. This process should not, I think, be viewed with alarm but with satisfaction and approval. After all, it is proof of the continued vitality of American industry.