

British Direct Investment in Western Europe

1. Introduction

This paper has two main objects. The first, which is essentially descriptive, is to provide an account of British direct investment in Western Europe in relation to British direct investment as a whole. In attempting this we make use not only of official data but also of some of the preliminary results of a private enquiry undertaken by the authors.

The second object is a good deal more ambitious. It is to consider, so far as the data we possess and economic theory permit, the costs and benefits accruing to the United Kingdom from direct investment in Western Europe. This as we shall see later has both long and short run aspects.

2. U.K. Direct Investment Overseas including Western Europe

In recent years British private direct investment (excluding investment in oil and insurance) has been running at an average rate of some £220 mns. per annum. If this figure is raised to take some account of overseas investment in oil and insurance, it would seem that direct capital exports by British companies amount to about 20% of the net fixed capital formation by British companies at home and abroad. If, instead of investment by the company sector, we look at private fixed capital formation as a whole, we find that total private investment overseas is about 20% of this total. In short, about one-fifth of the net fixed capital formation by the private sector of the British economy consists of investment overseas and there is no suggestion, at least in recent years, that this figure is falling. It is this high ratio which has led to considerable discussion in Britain as to whether overseas investment on this

scale entails a misallocation of resources — a problem we examine in later sections of this paper (1).

TABLE I

BRITISH PRIVATE INVESTMENT AT HOME AND OVERSEAS 1958-63 (£m.)

	Net fixed capital formation in the U.K.		Overseas investment (net of depreciation)		Col. 3 Col. 1+3 × 100	Col. 4 Col. 2+4 × 100
	Total Private	Company	Total Private	Company		
1958	937	762	307	226	24.7	22.9
1959	1,041	806	311	254	23.0	24.0
1960	1,290	959	314	281	19.6	22.7
1961	1,530	1,138	321	274	17.3	19.4
1962	1,403	1,089	253	239	15.3	18.0
1963	1,299	961	309	266	19.2	21.7

Source: *National Income and Expenditure 1964*, Table 67 and *Economic Trends*, September 1964.

In calculating company overseas investment, we have assumed that one-half the private investment « other than direct investment » is company investment in foreign oil and insurance enterprises.

From the data published by the Board of Trade it is possible to give both a distribution of annual direct investment overseas and the total of capital holdings. This distribution is set out in Table II. In interpreting this Table a number of points of definition need to be kept in mind. First, the total capital holdings of British firms overseas is the share of the capital of U.K. firms' associates, subsidiaries and branches attributable to British interests. Second, the estimate of total capital holdings is based upon book values which probably underestimate the value of such holdings in terms of replacement cost. Third, the basis of valuation is net assets — defined as net fixed assets plus current assets minus current liabilities. In the main, however, local borrowing in the overseas country is excluded from current liabilities. Hence when there is such borrowing net assets are overstated. Conversely when borrowing is from the parent company and is also included in current liabilities which are deducted to arrive at net assets, net assets are thereby understated. Fortunately (at least in this context) local borrowings are small.

(1) Cf. N.E.D.O. [12] pp. 36-39 and N.E.D.O. [13] pp. 11-12.

Hence though some distortion exists on the first count it, too, may well be small.

TABLE II

U.K. DIRECT CAPITAL INVESTMENT OVERSEAS

	Capital Stake at end 1957		Capital Stake at end 1962		Investment in					Growth in Capital 1957-62	
	£mn.	% of total	£mn.	% of total	1958	1959	1960	1961	1962	£mn.	%
					£mn.	£mn.	£mn.	£mn.	£mn.		
E.E.C. . . .	151.8	5.9	249	6.9	8.4	16.1	20.8	24.8	27.1	97.2	64.0
E.F.T.A. . .	48.1	1.9	84	2.3	2.9	0.7	3.9	10.7	17.5	35.7	74.2
Other European	19.5	0.7	29	0.8	2.5	3.1	0.5	2.2	1.3	9.6	49.2
Western Europe	219.2	8.5	362	10.0	13.8	19.9	25.2	37.7	45.8	142.5	65.0
All Countries .	2,578.5	100.0	3,600	100.0	143.5	196.0	247.0	226.0	209.0	1,021.5	39.6

Source: *Board of Trade Journal*, 4 Sept. 1962 and 7 Aug. 1964.

According to the Table the cumulated book value of U.K. companies' direct investment abroad (excluding oil and insurance) in 1962 amounted to £3,600 mns. Of this sum Western Europe as a whole accounted for £362 mns. — or 10% — with the E.E.C. share £249 mns. (69% of the Western European total) and the E.F.T.A. share £84 mns. (23%) (2).

If we look now at the marginal ratios, we find that the annual rate of investment in Western Europe has risen very considerably as a proportion of total annual direct investment. Moreover, perhaps rather surprisingly in view of the familiar argument that the tendency is for tariff barriers — and particularly their prospective growth — to induce investment by overseas firms, it is the share of investment going to E.F.T.A. which has shown the greatest rate of increase. Since for both E.E.C. and E.F.T.A. the marginal ratios exceed the average, the capital holding of U.K. companies in both areas is increasing as a proportion of total capital holdings

(2) Since this article was written, the foreign investment figures for 1963 have been published. The total capital stake of U.K. companies abroad at the end of this year amounted to £3,852 mns. of which £417 mns. or nearly 11% was invested in Western Europe. Of this latter figure £285 mns. or 68% was invested in the E.E.C. and £100 mns. or 24% in E.F.T.A. See *Board of Trade Journal* 2 April 1965.

overseas. In short, in recent years U.K. companies have devoted an increasing proportion of their far from negligible investment overseas to Western Europe with particular emphasis on investment in E.F.T.A.

TABLE III

U.K. DIRECT CAPITAL INVESTMENT IN WESTERN EUROPE - 1958-1962

	Capital Stake (1) (\$mn.) 1962	Investment (\$mn.)					Investment 1958-62 as % of capital 1962	
		1958	1959	1960	1961	1962		
Belgium	52	1.5	3.3	4.6	1.6	8.5	19.5	37.4
France	78	-0.4	4.4	5.3	9.4	4.9	23.6	30.3
Italy	34	0.1	1.8	4.0	2.6	-5.2	3.3	9.7
Netherlands	22	0.3	-0.1	2.0	1.9	5.6	9.7	44.1
W. Germany	63	6.7	6.7	5.0	9.2	13.2	40.8	64.8
E.E.C.	249	8.4	16.1	20.8	24.8	27.1	97.2	39.0
Denmark	10	0.4	0.3	0.7	0.9	1.5	3.8	38.0
Portugal	27	1.3	0.2	-0.1	0.6	1.3	3.3	12.2
Switzerland	27	0.6	0.1	1.6	4.4	12.7	19.4	71.8
E.F.T.A.	84	2.9	0.7	3.9	10.7	17.5	35.7	42.6
Other	29	2.5	3.1	0.5	2.2	1.3	9.6	33.1
Western Europe	362	13.8	19.9	25.2	37.7	45.8	142.5	39.3
Total all countries	3,600	143.5	196.0	247.0	226.0	209.0	1,021.5	28.4

— sign represents net outflow of U.K. capital from the country concerned.

(1) U.K. share of net assets of European companies in which there is a U.K. direct investment, plus value of capital invested in U.K. branch plants.

Source: Board of Trade Journal, 4 Sept. 1962 and 7 Aug. 1964.

In Table III we extend this description a little further by providing a breakdown of capital holdings and investment flows for particular countries in Western Europe. On the basis of the percentage of the 1962 capital holding in each country attributable to the total investment of the last five years, the most popular areas for investment have been Switzerland, Germany and the Netherlands; by contrast the least popular areas have been Italy and Portugal (3).

(3) It should be remembered that the Board of Trade data excludes the European investments of U.K. oil companies. Were these included and the statistics brought up-to-date the share of U.K. investment going to Italy would be greatly increased.

In concluding this brief description of the scale and distribution of U.K. direct investment in Western Europe two further points should be noticed. First the great bulk of British capital in Western Europe (more than 67%) is engaged in manufacturing. Of the rest, 3.4% is engaged in mining while the balance, which cannot be precisely allocated, is employed in construction, distribution, transport and communications and "other industries". Second, some 40% of British investment in Western Europe has been financed by re-invested profits — a proportion not significantly different from the overall proportion and one which has remained relatively constant for the period 1958-1962. The balance has, of course, been provided by an inflow of share and loan capital from the U.K., an increase in the indebtedness of European branches to their U.K. parent companies and certain changes in inter-company accounts.

This brief review has, for obvious reasons, been concerned with U.K. investment. As an aid to perspective in the matter we include Table IV which compares U.K. with U.S. direct investment in Western Europe.

TABLE IV
TRENDS IN U.K. & U.S. INVESTMENT IN W. EUROPE 1958-62

	U.K. Capital Stake			U.S.* Capital Stake		
	1958 (\$mn.) (1)	1962 (\$mn.) (2)	Change % (3)	1958 (\$mn.) (4)	1962 (\$mn.) (5)	Change % (6)
Belgium	34	52	53	155	225	45
France	54	78	41	359	749	154
Italy	31	34	10	141	311	121
Netherlands	13	22	69	95	207	118
Germany	29	63	117	492	1,096	223
E.E.C. Total	160	249	55	1,242	2,588	108
Portugal	25	27	8	—	37	—
Switzerland	8	27	239	60	517	762
Denmark	7	10	43	23	38	65
E.F.T.A. Total	51	84	65	375	(872)	293
Other	22	29	32		(140)	
Total	233	362	55	1,617	3,600	123

* All investment minus that in petroleum.

Sources: Cols. (1) and (2) Board of Trade data. Cols. (4) and (5) U.S. Department of Commerce data.

This makes it clear that not only was the total U.S. capital holding in 1962 very much greater than that of the United Kingdom, but its proportionate rate of growth over the past 5 years was more than twice as fast. Moreover, though the U.S.A. seems to have invested relatively faster in E.F.T.A. than in E.E.C. — primarily because of massive investment in Switzerland — its distribution of investment between countries differs. Since U.S. capitalists have, in general, been rather more successful (in terms of the average rate of return on capital employed) in allocating their overseas investment than their U.K. counterparts, this may well be a point of some significance (4).

3. The Southampton Enquiry: Coverage and Definitions

All the data used to provide the description in Section 2 of this paper comes from official sources. Further light on some problems can be derived from the preliminary results of the authors' own enquiry. However, before discussing the results of this, some points must be made regarding coverage and definition.

The Southampton enquiry was limited to manufacturing which, as we have seen, accounts for more than two-thirds of U.K. capital in Western Europe. It was also restricted to those U.K. parent or associated companies which hold 25% or more of the equity interest of any European company. Of the companies falling into this group approximately half gave statistical information relating to their European operations. Unfortunately among the concerns which proved unwilling or unable to provide information (in the form of a questionnaire) were one or two major British investors. As a result, non-response has a very serious effect on coverage and correspondingly distorts the pattern of results.

The effect on coverage can be seen from Table V which compares the totals of net assets derived from the Southampton enquiry with figures kindly provided for the authors by the Board of Trade.

As this Table makes clear, in only two cases — West Germany and Norway — can coverage be called good. In two further cases — France and the Netherlands — coverage approximates to the proportion of firms responding to our questionnaire enquiries. In

(4) On the relative profitability of U.K. and U.S. enterprises cf. J. H. DUNNING [5] and J. H. DUNNING and D. C. ROWAN [6].

TABLE V

U.K. SHARE OF TOTAL ASSETS, NET ASSETS & NET WORTH OF MANUFACTURING SUBSIDIARIES & ASSOCIATES IN WESTERN EUROPE - 1962

	Southampton Enquiry (Manufacturing Industry)				Board of Trade (5) Net Assets £mn.	Net Assets « coverage » Col. (1) to (5) %
	(1) Net Assets £	(2) Net Worth £	(3) Total Assets £	(4) No. of Firms		
France	19,781,384	19,034,971	21,652,811	26	44.8	44.2
Belgium	4,998,605	3,870,050	5,646,422	10	41.6	12.0
Italy	5,445,728	4,595,905	7,016,819	9	29.9	18.2
Netherlands	4,746,214	4,401,798	5,191,317	17	10.5	45.1
W. Germany	40,606,973	40,053,367	41,730,640	19	51.6	78.6
Total E.E.C.	75,578,904	71,956,091	81,238,009	81	178.4	42.4
Norway	3,274,780	628,780	2,677,500	2	5.0	60.6
Denmark	2,658,258	2,362,055	3,767,335	6	6.7	39.7
Sweden	454,112	457,685	540,364	3	8.8	5.1
Switzerland	2,450,000	2,450,000	2,578,282	2	21.7	11.3
Portugal	679,127	654,327	728,954	1	5.3	12.8
Austria	306,382	306,401	306,818	2	2.1	14.6
Total E.F.T.A.	9,822,659	6,859,248	10,599,253	16	49.6	19.7
Spain	385,334	385,334	472,544	2	6.9	
Greece	288,070	288,070	353,458	1	0.4	
Malta	340,335	340,335	340,335	1	0.7	
Turkey	56,108	56,108	69,923	1		
Ireland	85,197	85,197	85,197	1		
Finland	87,547	87,547	88,758	1		2.4
Total « Other »	1,242,591	1,242,591	1,410,215	7	10.4	11.9
Total E.E.C.	75,578,904	71,956,091	81,238,009	81	178.4	42.4
Total E.F.T.A.	9,822,659	6,859,248	10,599,253	16	49.6	19.7
Total « Other »	1,242,591	1,242,591	1,410,215	7	10.4	11.9
Total W. Europe	86,644,154	80,057,930	93,247,477	104	238.4	36.4

Board of Trade data, kindly provided direct to Southampton enquiry. This does not include an allowance for non-response.

general, however, the degree of coverage fluctuates severely — from the 5.2 per cent in the case of Sweden to the relatively high figure of 78.6 per cent for West Germany. It follows that extreme caution must be used in interpreting the Southampton results or in using them to supplement information from official sources: for not only are the Southampton results in some degree non-representative but there is no means of knowing how far the degree of non-representation, which clearly differs between countries, distorts the results for any country. Nevertheless, despite these shortcomings, certain subsidiary information of some interest can be obtained from the Southampton data as we shall see in later sections.

4. Profitability

Estimates of the rates of return on U.K. capital in Western Europe can be derived from the Board of Trade data for each year from 1958 to 1962. The results are set out in Table VI which shows

TABLE VI

AVERAGE RATES OF RETURN ON U.K. INVESTMENT OVERSEAS:
WESTERN EUROPE - 1958-1962

Country or Area	% Rate of Return (Average 1958-62) Board of Trade data	% Rate of Return (Average 1958-62) Southampton enquiry
Western Europe	8.6	15.2 (8.9) *
E.E.C.	8.9	15.8 (8.7) *
E.F.T.A.	8.2	9.9
Other European	7.9	13.2
Belgium	3.5	3.1
France	3.8	3.5
Italy	1.2	-0.6
Netherlands	11.4	12.2
W. Germany	28.3	26.5
W. Germany *		17.5
Switzerland	8.4	n.a.
Denmark	6.1	n.a.

* Excluding two highly profitable firms.

Sources: J. H. Dunning [5] Table II, p. 11 for Col. (2). Southampton Enquiry, for Col. (3).

the estimated average rate of return for the period 1958-1962 defined as net profits (after tax) expressed as a percentage of net assets.

The figures have been presented in this way because it is probable that the estimates for individual years are of lesser reliability than those for the period 1958-1962 as a whole. If this is so, it seems that the rate of return, as defined, from investment in Western Europe is of the order of 8.5%. Three countries — Italy, Belgium and France — show rates substantially below this figure. Two countries — West Germany in particular, and to a lesser extent the Netherlands — show rates substantially above this average.

The Southampton data can also be arranged to yield estimates of profit rates as defined above. These are given in Col. (3). For those countries for which the Southampton net asset coverage seems "reasonable", namely West Germany, France and the Netherlands, the Southampton profit data is broadly consistent with that derived from the Board of Trade publications for its yields for West Germany 26.5%, France 3.5% and the Netherlands 12%. Indeed it is only for E.E.C. as a whole, for which the Southampton enquiry gives a rate of 15.8%, and for "Other European" where it provides an estimate of 13.2% that discrepancies are severe. In part, no doubt, these discrepancies are to be explained by the fact that the Southampton enquiry covers only manufacturing industry. The main source of error, however, seems certain to be inadequate and uneven coverage. Response, it appears, may have been related to profitability and profitability may well differ very sharply between U.K. concerns operating in the same country.

An instance of this latter effect can be given from the Southampton data. In the case of West Germany — where the Southampton coverage is particularly good — two large firms have a very marked influence on the rate of profit. If these two are excluded, the rate of profit applicable to West Germany falls from 26.5% to 17.5%. It thus seems likely that the high rate of return attributable to West Germany in both the Board of Trade data and our own data may reflect, to a considerable extent, the very high rates of profit earned by these two enterprises. Hence, where coverage is poor, considerable differences in the estimated rate must be expected.

Purely for purposes of putting these rates of return into perspective Table VII presents further data on rates of return. This is of two types. In the first place it consists of rates of return on U.K.

direct investment in areas *other* than Western Europe. These rates, calculated in the same way as those in Table VI, are derived from the data provided by the Board of Trade. In addition the Table also provides an estimate of the conceptually comparable rates of return obtained by the largest public companies operating in the United Kingdom.

TABLE VII

AVERAGE RATES OF RETURN ON U.K. INVESTMENT OVERSEAS - 1958-1962

Country or Area	Rate of Return Per cent (Average 1958-62)
All Countries [Net Income (after Tax) / Net Assets] .	7.9
North America	4.5
Canada	3.4
U.S.A.	6.6
Latin America	9.2
Argentina	10.9
Brazil	14.9
Other Non-Sterling Area	10.4
Overseas Sterling Area	9.5
South Africa	10.9
India	8.8
Australia & Dependencies	7.2
New Zealand	6.5
Rhodesia & Nyasaland	12.9
Malaya	15.6
United Kingdom	
Net Income (before Tax) / Total Assets	10.3
Net Income (before Tax) / Net Assets	13.8
Net Income (after Tax) / Total Assets	5.8
Net Income (after Tax) / Net Assets	7.8

Source: J. H. Dunning [5] Table II, p. 11.

On the basis of this information we can reach a number of tentative conclusions.

The average rate of return obtained from investment in Western Europe in 1958-1962 was higher than the overall average rate of return obtained on direct investment as a whole. This is true for both E.E.C. and E.F.T.A.

The average rate of return in Western Europe was marginally below that obtained in Latin America, the Overseas Sterling Area and other non-sterling countries. It was, however, nearly twice the rate obtained in North America.

The average rate of return in Western Germany was nearly twice that of the next highest rate (Malaya) while the average rate earned in the Netherlands, if some allowance is made for risk, is probably not significantly different from the apparently higher average rates earned in Malaya, Rhodesia and Nyasaland and Brazil. On the other hand, no other country reveals a rate of return as low as Italy and only Canada has a rate of return as low as France or Belgium. Thus, though in aggregate Western Europe compares favourably with the other major areas, it is clear that British experience in the various countries of Western Europe has differed very markedly. It seems possible to do very well in Europe. Equally it seems possible to do very badly.

These profit figures are aggregates in which the profit rates of individual enterprises are weighted by their cumulative investment in each area. It is known that, in Western Europe, the ten largest U.K. investing companies are responsible for 53% of the cumulative investment up to 1962. Moreover, as the Southampton enquiry for Western Germany demonstrates, the apparent rate of return from a particular country can be heavily influenced by the results of one or two large firms. How far do overseas enterprises earn rates close to the average?

This question is simpler to ask than answer. From the Southampton enquiry, however, it is possible to give some data relating to Western Europe. It is, unfortunately, not possible to say how far this data is reliable. The data available, for the single year 1962, is set out in Table VIII. This shows that some 27% of firms made losses in this year including one-third of the firms with total assets in excess of £5 mns. In no country were U.K. enterprises *all* profitable. In Italy as many firms made losses as profits. The proportion of enterprises making losses in Western Europe is not notably higher than was found to be the case for U.K. enterprises in North America which, for the years 1955-1960, was approximately 20% (5).

(5) DUNNING [3], p. 57.

That there should be a scatter of results in terms of profit is not very surprising. The distribution of profits between firms in any industry in any period is known to vary widely. For what it is worth, however, Table VIII suggests that the Board of Trade aggregates, which yield a rate of return for Western Europe higher than that for overseas investment as a whole, conceal a performance which, in terms of particular projects, is very varied and may indeed be more varied than that experienced elsewhere.

TABLE VIII

NUMBER OF U.K. SUBSIDIARIES & ASSOCIATES IN WESTERN EUROPE
MAKING PROFITS & LOSSES, 1962

Size (Net Assets) £ 000	Belgium		France		W. Ger- many		Holland		Italy		Total E. E. C.		E. F. T. A.		Other		Total	
	Profit	Loss	Profit	Loss	Profit	Loss	Profit	Loss	Profit	Loss	Profit	Loss	Profit	Loss	Profit	Loss	Profit	Loss
Under £100 . . .	1		5	3		1	5	2		1	11	7	5	1	2	1	18	9
£100 - £500 . . .	4	1	7	1	5	2	4	2	2	2	22	8	2	1	3	1	27	10
£500 - £1,000 . . .	1		4	1	2	1	1			1	8	3	4		1		13	3
£1,000 - £5,000 . . .	3	1	5	1	4		1		3	1	16	3	2	2			18	5
Over £5,000 . . .			1	2	3						4	2					4	2
Total	9	2	22	8	14	4	11	4	5	5	61	23	13	4	6	2	80	29

Finally, there is one more conclusion to be drawn from Table VII. This is that on the basis of these aggregate rates, U.K. overseas enterprises are, on average, almost exactly as profitable as U.K. enterprises at home. Moreover, in many countries, and particularly of course in West Germany, U.K. enterprises earn a substantially higher rate of return than they do at home. Equally, in seven countries, of which Italy is the outstanding example, they earn substantially less.

5. The Efficiency of British Direct Investment

The profitability estimates, whether they are derived from the data published by the Board of Trade or our own enquiry, can be used to throw some light on problems raised by other investigations. One such problem is the relative efficiency of U.K. and U.S. direct investment in Western Europe.

In earlier papers evidence has been produced to suggest that U.S. capitalists consistently obtain a higher rate of return on direct investment overseas. Indeed the first results of a second Southampton enquiry suggest that U.S. firms operating in the United Kingdom obtain on average a higher rate of return on their investment than U.K. firms operating in the same industry (6). Is this pattern repeated in Western Europe? We might expect that it would not be since the economic and political connections of the United Kingdom with Western Europe, though not as close as some might wish, are after all a good deal closer than those of the U.S.A.

In Table IX we have set out the rates of return on net assets, after tax and depreciation, of U.K. and U.S. direct investment in Western Europe together with the overall average obtained by both countries.

From this Table it is clear that, in Western Europe as a whole, the familiar pattern of relative performance repeats itself. U.S. capitalists obtain a substantially higher rate of return. Moreover, their relative advantage in Western Europe is greater than their overall relative advantage and, surprisingly enough, greater than their relative advantage over British enterprises operating in the U.S.A. itself.

As far as the division of Western Europe is concerned, U.K. enterprises appear to do relatively better in E.E.C. than elsewhere. In only one country, Western Germany, do British enterprises obtain a higher rate than U.S. enterprises. Conversely, in Italy U.S. enterprises do more than ten times as well; in Belgium nearly five times as well; in Switzerland more than three times as well and in France more than twice as well. It is, in fact, in Western Europe that one finds the greatest discrepancies between U.K. and U.S. performance. If we remember that the U.K. figures for Western Germany are very heavily influenced by the high rates of return obtained by the two largest U.K. investors it is probably true to say that, though U.S. enterprise is generally more profitable than U.K. enterprise, its greater profitability is demonstrated particularly dramatically in Western Europe. This conclusion is reinforced by the consideration that the data for U.S. investment do not permit us to calculate net income/net assets but only net income/total assets. They therefore understate U.S. profit rates by a factor which

(6) J. H. DUNNING & D. C. ROWAN [6].

TABLE IX

COMPARATIVE RATES OF RETURN EARNED BY U.K. & U.S.
DIRECT INVESTMENT OVERSEAS - 1958-62 - %

	1958		1959		1960		1961		1962		Average 1958-62	
	U.K.	U.S.	U.K.	U.S.	U.K.	U.S.	U.K.	U.S.	U.K.	U.S.	U.K.	U.S.
North America . . .	4.8		4.9		4.2		3.9		4.5		4.5	
Canada	4.0	7.3	3.7	8.3	3.1	7.3	3.0	6.3	3.4	7.7	3.4	7.4
U.S.	6.6	(9.0) (1)	7.4	(9.8)	6.3	(9.1)	5.9	(8.7)	6.6	(9.0)	6.6	(9.1)
Latin America . . .	10.2	7.5	9.8	8.6	11.0	8.8	7.4	9.6	7.8	10.1	9.2	8.9
Argentina	12.0	3.6	14.0	6.6	16.1	9.7	6.5	13.5	6.0	10.0	10.9	8.7
Brazil	21.4	5.1	12.1	6.7	16.0	8.7	11.2	6.8	9.6	8.3	14.1	7.1
Western Europe . .	7.1	15.8 (2)	10.1	15.5	8.5	15.5	9.5	16.0	7.9	13.9	8.6	15.3
E.E.C.	7.1	15.1	10.7	15.3	8.1	14.7	9.9	14.4	8.5	11.7	8.9	14.2
Belgium	2.2	14.2	4.6	12.2	1.8	19.0	3.2	21.4	5.7	19.1	3.5	17.2
France	1.6	12.8	6.9	8.8	3.7	8.9	4.2	6.9	2.4	5.7	3.8	8.6
Italy	0.7	13.5	2.3	20.2	0.6	12.9	3.5	9.5	-1.3	8.7	1.2	13.0
Netherlands . .	7.2	8.4	12.7	11.9	12.3	12.1	14.8	11.0	9.8	10.1	11.4	10.7
W. Germany . .	31.3	18.9	31.3	22.2	27.8	18.6	28.1	19.8	23.2	15.5	28.3	19.0
Other	7.0	18.2 (2)	8.8	16.4	9.3	18.3	8.6	21.6	6.4	20.2	8.0	18.9
U.K.	(7.7) (3)	13.8	(8.7)	15.4	(8.5)	12.2	(7.4)	11.0	(6.8)	9.9	(7.8)	12.5
Switzerland . . .	7.7	29.0	9.1	17.0	11.4	20.7	10.3	23.0	3.6	21.1	8.4	22.2
Denmark	7.1	13.0	8.5	20.0	6.1	18.5	5.3	29.4	3.3	18.4	6.1	19.9
Rest of the World	9.2	14.7	9.8	14.7	10.4	15.4	8.9	14.0	9.2	14.0	9.5	14.6
South Africa . . .	10.5	13.1	9.9	13.3	11.4	17.5	10.4	19.4	12.4	20.4	10.9	16.7
India	8.5	14.2	8.5	12.5	9.0	8.8	8.9	12.2	9.0	11.7	8.8	11.9
Australia	7.5	13.7	8.1	13.7	7.9	11.8	5.6	8.1	6.7	10.3	7.2	11.5
New Zealand . . .	6.7	18.0	5.0	16.7	8.8	20.8	5.2	19.0	7.0	17.1	6.5	17.1
Fed. of Rhodesia & Nyasaland . .	14.3	18.0	13.7	16.7	14.7	23.2	11.5	16.1	10.1	10.8	12.9	15.7
Other Countries . .	10.6	18.6	12.1	16.8	12.4	20.1	10.9	17.7	10.0	17.2	11.2	18.1
All Countries (4) . .	7.7	9.8	8.3	10.7	8.4	10.4	7.4	9.9	7.7	10.3	7.9	10.2

Source: U.S. data — U.S. Department of Commerce *Survey of Current Business*. U.K. data — Derived from statistics published in *Board of Trade Journal*, 14 November 1962, pp. 555-557 and 7 August 1964, pp. 286-296.

(1) Net income (a.t.)/net worth ratio for leading U.S. corporations (including those in petroleum and insurance). Source: *First National City Bank of New York*.

(2) Excluding U.K. 1958-62.

(3) Net income (a.t.)/net assets ratio for U.K. public companies in manufacturing and distribution. Source: *Economic Trends*, April 1962 and Dec. 1963.

(4) Excluding domestic rates of return (i.e. as bracketed in the table) on both U.K. and U.S. capital.

is unknown but may be of the order (for investment as a whole) of one-tenth (7).

From this Table it seems obvious that assuming the objective is to maximise the rate of return as defined, U.S. firms, in undertaking direct investment in Western Europe, have chosen more wisely than U.K. firms. This is probably a reflection of their greater skill at identifying growth industries (8). This point, however, requires further investigation before it can be regarded as established. Obviously, if this is in fact the explanation, British investment must, in some instances, have been startlingly misdirected. In Italy, for example, the highest rate earned by U.K. firms in any year was 3.5% in 1961. By contrast the lowest rate earned by U.S. enterprise was 8.7% in 1962 — the highest rate 20.2% in 1959 — while over the five years 1958-1962 the average rate of return obtained by U.S. enterprises in Italy exceeded the rates obtained by U.K. enterprises in all countries for which we have data other than West Germany and Brazil. The Italian case, it seems clear, would repay further detailed study.

It can, of course, be argued that these comparisons are based upon data of doubtful value which may not be strictly comparable. This is, in some unknown degree, the case. It seems, nevertheless, improbable that the widely and consistently differing performances of U.K. and U.S. enterprises — as indicated by Table IX — could be entirely explained by shortcomings in the statistics. Our provisional conclusion can only be that, relative to their U.S. rivals, U.K. capitalists have been poor selectors of investment opportunities and that this is particularly the case in Western Europe.

6. Costs and Benefits of Direct Investment: Long-Run Aspects

As we have shown in earlier sections of this article, U.K. companies' direct investment overseas amounts to about 20% of all the fixed capital accumulation of the company sector of the U.K. economy. This is far from a negligible figure. Of this, the share of Western Europe is of the order of a quarter, or some 5% of the total fixed capital accumulation of the U.K. company sector. It is

(7) This "overstatement factor" may, of course, differ between countries.

(8) Cf. DUNNING [5].

therefore worth asking: how far does direct investment overseas on this scale represent an optimal allocation of U.K. resources?

The problem of the overall allocation of investment between investment overseas on the one hand and investment at home upon the other has received extensive discussion in the literature. The writings on this issue tend to fall into two groups.

The first group of writers approaches the problem as one of resource allocation in a perfectly competitive world which is taken to be in long-term full employment equilibrium (9). External equilibrium is assumed to be maintained without cost to the lending country — that is there is no transfer problem. Production functions in each country are taken to be homogeneous of degree one in the factor inputs and invariant with respect to foreign investment. Given a model of this type it is, *on the basis of invariant terms of trade*, possible to show that the marginal social product of investment overseas will be less than the marginal social product of investment at home. In short, that “under competitive conditions capital rich countries tie up too great a proportion of their resources in foreign ventures” (10).

This theoretical conclusion is strengthened by the fact that while the tax on profits arising out of investment at home accrues to the home government, the tax on profits arising out of investment abroad accrues, in general, to the foreign government.

Unfortunately, even on their own assumptions, these conclusions are not acceptable. For, in general, in a perfectly competitive world of the type postulated, an act of foreign investment is likely to change the terms of trade. Where the investing country engages extensively in international trade the effect of any change in the terms of trade will have a significant influence on the marginal social product of overseas investment. It follows, therefore, that in comparing the marginal social products of investment at home and abroad the behaviour of the terms of trade is likely to be crucial. The difficulty now arises, however, that in a perfectly competitive model of long-run equilibrium it is not possible to predict the sign of any change in the terms of trade even when the model is

(9) The best known discussions along these lines are the following: A. E. JASAY [9]; Sir DONALD MACDOUGALL [11]; M. C. KEMP [10]; and P. B. SIMPSON [15]. Not all the assumptions given in the text are made by each of these writers. For a useful general review consult E. L. WHEELWRIGHT [16].

(10) KEMP [10].

simplified by assuming only two countries (each producing an exportable, an importable and a non-traded good) without making strong additional assumptions regarding the parameters of the demand and supply functions involved. The approach to the problem along the lines of resource allocation in long-term full employment equilibrium thus yields an indeterminate result and eliminates any *a priori* presumption regarding the relative merits of investment at home and abroad (11).

The second line of approach to the problem begins by pointing out the very restrictive assumptions which are the basis of the long-run equilibrium analyses (12). The conclusion derived from this line of attack on the problem is given in the following quotation.

“Once the assumptions of perfect competition, divisibility of factors and products, diminishing marginal productivity of capital, constant terms of trade and adjustments to equilibrium positions are abandoned, it is impossible to say with certainty whether, from a rational point of view, investing abroad is preferable to investing at home, or whether foreign capital should be attracted into or kept out of the country. Much depends on the industries and the conditions in which the investment takes place” (13).

We may thus conclude that whether we approach the problem of the social choice between domestic and foreign investment along the traditional lines of long-run static full employment equilibrium analysis or in a more agnostic and sceptical spirit, the only general conclusion is that no general conclusion is possible. Moreover, we cannot hope to resolve the dilemma by appealing to the “facts” for, though a static long-run theory can be developed in terms of measurable parameters independent of the problem itself, there are as yet no estimates of the numerical magnitude of them. Equally, though we have data on average rates of return, such as are set out in Tables VI and VII, the relevance of these to the problem in hand is by no means beyond dispute.

To see this, consider our own data. The rate of return, gross of tax but net of depreciation, on the net assets of about 2,000 British public companies was, on average over the period 1958-1962,

(11) I. F. PEARCE and D. C. ROWAN [14].

(12) T. BALOGH and P. STREETEN [1].

(13) BALOGH and STREETEN [1], p. 223.

just under 14%. If this is taken to be a reasonable approximation to the marginal social product of domestic investment, which involves assuming average rates and marginal rates of return to be equal, the apparent social rate of return on domestic investment in this period was some 6% above the apparent social rate of return on overseas investment (on the same assumption) which, for the same period, averaged 7.9%.

This calculation, which seeks to estimate the marginal social rate of return on direct overseas investment by the marginal private rate of return net of overseas tax is, however, easily upset even if we continue to assume that the average rates, which are observable, are good estimates of the marginal rates. This is so, amongst other reasons, because as we have seen overseas investment may change the terms of trade.

Suppose, for example, that, as a result of overseas investment, the terms of trade are 1% worse than they otherwise would have been. Since a 1% change in the terms of trade is worth £50-60 mns. a year to the United Kingdom then, by assumption, this sum must be subtracted from the recorded earnings of overseas investment to obtain the "social" earnings. Such a subtraction would reduce the apparent social rate of return, estimated on the lines set out above, by about one-quarter — say to between 6-6¼%. Conversely, if the terms of trade had improved by 1% the apparent social rate of return on overseas investment would need to be increased to between 9½-10%.

In addition, it is commonly argued that there are payments, not classified as profits or interest in the official data, which strictly fall to be included in calculating the rates of return on investment overseas. These arise out of payments made to the investing companies by overseas subsidiaries and associates for such items as royalties and service fees. A rough correction for this element raises the overseas rate of return to about 8.6%.

Finally there is evidence that, by investing in certain areas, particularly in North America, British firms have improved their domestic performance through the absorption of techniques of production and management superior to their own (14). This "technical transference effect" may well be quite significant. There is, however, no obvious way of estimating its quantitative signifi-

(14) Cf. DUNNING [2 & 4].

cance. It is possible, nevertheless, that if allowance could be made for it, it would bring the adjusted average rate of return on overseas investment close to the apparent social rate of return on domestic investment, for these benefits, in so far as they are reflected in the profits of the investing companies, are already included in our estimates of the domestic rate of return (and ought not to be) and are not included at all in our estimates of the overseas rate of return (where they ought to be) (15).

Thus though it may be correct, in some sense, to argue that: "Unless the direct and indirect yields of investment abroad are very high, there is some presumption that, from a national point of view, domestic investment is preferable at the margin" (16), there appears to be, in practice, no method of giving a meaning to "very high" or identifying "the margin". Equally it is not at all easy to see, in this context, what precisely is meant by "yields" or how they can be measured.

On the basis of the long-run or "allocative" approach therefore, it seems that nothing can be said with any confidence. The present scale of British direct investment overseas may be optimal (in the sense defined above) or it may not. If it is not, we have no way either of showing this to be the case or of saying whether it is too great or too small (17).

7. Costs and Benefits of Direct Investment: Short-term Aspects (18)

In the previous section of this paper we presented an outline of the long-run or "allocative" approach to the problem of assessing the costs and benefits of direct overseas investment. As we saw above, this approach, though well established in the literature, permits no firm conclusion to be drawn regarding the relative marginal social rates of return on domestic and overseas investment

(15) As far as Western Europe is concerned 39 per cent of firms responding to the Southampton enquiry reported gaining knowledge through the operation of European subsidiaries. On the general problem of these gains cf. J. H. DUNNING & D. C. ROWAN [7].

(16) BALOGH and STREBYN [1].

(17) In his recent Budget the Chancellor of the Exchequer (Rt. Hon. James Callaghan, M.P.) used figures very similar to those given in this paper in announcing policy changes designed to restrict direct overseas investment. *Hansard* (6 April, 1965), cols. 261-265.

(18) This description of the problem is the Chancellor's. *Hansard* (6 April, 1965), col. 263.

because, even if we accept the relatively simple model presented in [11], we cannot, in the absence of quantitative evidence regarding the magnitude of the parameters of the demand and supply functions involved, determine the sign or magnitude of the change in the terms of trade.

In addition, it is not entirely clear that the basic assumptions of the long-run model are applicable to the contemporary British problem. This model, it is recalled, assumes that real resources are transferred by the investing country. It follows that, given this assumption, domestic and overseas investment are alternative uses of available resources and hence that it is appropriate to frame the problem in allocative terms. In the British case, the balance of payments is not invariably in equilibrium. Over the cycle there has been a tendency to severe deficits during "expansion phases". There is also some evidence of the existence of a "fundamental" — as opposed to temporary or cyclical — disequilibrium. Hence, in part, British direct investment has been financed not by the generation of a current account surplus but by borrowing. Since direct investment outside the sterling area — and thus in Western Europe — is subject to exchange control, it is necessary for the authorities to formulate criteria by which applications for official exchange from companies contemplating overseas investment can be judged. In view of the persistent nature of the United Kingdom's external difficulties it is not surprising that the criteria employed emphasize the impact of investment on the balance of payments.

According to the Chancellor of the Exchequer (Rt. Hon. James Callaghan, M.P.) applications for official exchange with which to finance direct investment outside the sterling area are now examined from two points of view. The relevant passages of the Chancellor's statement are as follows:

"First, the project must bring a substantial continuing return to the United Kingdom balance of payments — for example, in additional export earnings. Secondly, there must be good prospects that the overall return to the balance of payments will, within the short-term, equal or exceed the capital outflow.

In all cases where official exchange is allowed in future, or has been allowed since July 1961, the Bank of England will call for periodic reports to show how the return actually achieved in exports

or otherwise compares with the expectations, on the basis of which permission was given for the use of official exchange" (19).

The two criteria set out in the first paragraph quoted can fairly readily be formulated in a way which may be helpful.

Suppose we write the value of the investment project as I_r and assume that some proportion (λ) of the initial expenditure (I_r) will, in fact, be carried out in sterling — let us say for the purchase of British goods. The initial foreign exchange requirement is then:

$$I_r(1 - \lambda).$$

In practice this foreign exchange can be obtained from two sources. The first is exchange in the hands of the authorities (official exchange). The second is the accruing foreign exchange receipts of the applicant firm derived from the profits of its past overseas investments which have not been remitted to the United Kingdom. For a firm making its initial overseas investment the latter item is zero. Moreover, even when it is not zero, since the profits *could* have been remitted, the foreign exchange cost of the investment must still be taken as $I_r(1 - \lambda)$ since this is, in effect, the debit item on the balance of payments arising out of the overseas investment of I_r . For simplicity, therefore, we shall assume that the whole of the foreign exchange, $I_r(1 - \lambda)$, falls to be provided by the authorities.

In each of the i years of its life the investment (I_r) will yield returns in foreign currency of Q_i . For each year these yield a rate of gross profit defined by:

$$P_i \equiv \frac{Q_i}{I_r}$$

so that the earnings, in any year i , coming from gross profit are:

$$P_i I_r \text{ where } i=1, 2 \dots n.$$

Of these gross profits some part (t) will be taken in tax by the foreign government and some part (d) of the profits after tax will

(19) *Hansard* (6 April, 1965), col. 263.

be retained in reserves overseas. Hence, in year 1 the *remitted* profits are:

$$I_r \cdot P_1 (1 - t) (1 - d).$$

If the foreign investment has an impact on exports — as a whole — and we write the increase in U.K. exports in year 1 resulting from the investment as ΔE_1 we have:

$$I_r \cdot P_1 (1 - t) + \Delta E_1$$

as the foreign exchange generated by the investment and

$$I_r \cdot P_1 (1 - t) (1 - d) + \Delta E_1$$

as the foreign exchange remitted as a result of the investment.

Proceeding on these lines and writing,

$$\Delta E_i \equiv c_i I_r$$

we can define the “marginal rate of return (in terms of foreign exchange) on the initial foreign exchange expenditure” by the following equation:

$$I_r (1 - \lambda) = \sum_{i=1}^{i=n} \frac{I_r P_i (1 - t) (1 - d) + I_r \cdot c_i}{(1 + r)^i} \dots \quad [1]$$

where r denotes the “marginal efficiency of foreign investment in terms of foreign exchange”.

This formula is, rather obviously, a crude approximation to the proper definition of r since it neglects the foreign exchange remitted in years 2 to n out of the earnings on reserves held overseas. For large values of n it is, however, a close approximation to the correct value and, even for values of n around 10, possibly the sort of value the authorities have in mind in defining the “short-run”, the error involved in using [1] is not too great to be acceptable.

It seems as if the first criterion mentioned by the Chancellor implies a concept of this kind even though equation [1] underestimates r . Presumably, since the annual cost of the investment (in terms of foreign exchange) is the interest which has to be paid to foreigners to obtain $I_r (1 - \lambda)$ — let us call it i_s — the *prima facie* requirement for approval is:

$$r - i_s > 0$$

provided i_s is defined net of the tax charged on interest payable to foreigners (20).

It is worth noting that this condition could be satisfied even if all the P_i were zero (or even negative) provided the ΔE_i were large enough. Conversely it could hold if all the ΔE_i were zero or negative if the P_i were large enough. All that $r - i_s > 0$ implies is that if the foreign investment is carried out with funds borrowed at the rate i_s then, after a deficit of $I_r (1 - \lambda)$ in period 0, there is “a continuing net return to the United Kingdom balance of payments”. Obviously the condition does not imply optimal resource allocation in the sense of the long-run analysis.

Suppose all the $P_i (1 - t)$ are equal and approximate the present average rate of return on direct investment of 8 per cent. Then $P (1 - t) (1 - d)$ would be slightly in excess of 4%. This gives a value of r , if all the ΔE_i are zero and $\lambda = 0$ less than 4%. This in its turn is probably not far from the average net cost of borrowing. It follows that the value of the ΔE_i is likely to be crucial as is the value of λ .

Borrowing abroad reduces the international liquidity of the United Kingdom. This is particularly the case since much borrowing is at short-term. It thus increases the risk of speculative attack on the pound. The second criterion mentioned by the Chancellor seems to represent an attempt to take account of this risk by requiring a short “pay-off” period in terms of foreign exchange. Formally this requirement may be written:

$$\sum_{i=1}^{i=s} I_r P_i (1 - t) (1 - d) + \Delta E_i \geq I_r (1 - \lambda) \dots \quad [2]$$

where $s \leq n$ is the number of years which constitute the “short-term”.

There is, of course, no information as to the length, in terms of years, of this “short-term” within which “there must be good prospects that the overall return to the balance of payments must equal or exceed the capital outflow”. Suppose, however, that it was 10 years, i.e. $s = 10$ — which is almost certainly a very generous

(20) Strictly the relevant cost is the marginal interest cost of inducing foreigners to hold additional short-term sterling liabilities. For an estimate of this cost in the case of the U.S.A. consult H. P. GRAY [8]. GRAY put the marginal cost of attracting short-term funds at above 10%.

estimate — then, if λ is close to zero, rather less than half the value of initial deficit will be accounted for by remitted profits, and if $s=5$ less than a quarter. Once again it is the values of the ΔE_i which appear to be crucial. This, of course, assumes that all the P_i are equal. If they are not what matters, for any given r , is how the ΔE_i and P_i are distributed over the s years taken by the authorities to define the "short-term" mentioned by the Chancellor.

This attempt to formulate the Chancellor's criteria explicitly is plainly something of an oversimplification. Nevertheless it does seem to show the rationale of the importance attached by the exchange control authorities to λ and the ΔE_i . Our exposition is not, of course, either an analysis or a justification of the criteria but simply an interpretation. Thus far, indeed, our discussion has been virtually devoid of economics.

If we now introduce a little economics we can immediately see the formidable difficulties standing in the way of estimating, for any particular investment, the P_i and the ΔE_i .

As far as the P_i are concerned the difficulties, though formidable, are familiar for, by definition,

$$P_i = \frac{Q_i}{I_r}$$

where Q_i is simply the return expected in year i from the investment I_r . Hence in so far as firms can estimate the Q_i — as if they are profit maximisers they must attempt to do in order to programme their investment — they can also estimate the P_i . How good their estimates are likely to be is another matter.

Estimating the ΔE_i is an entirely different problem. First of all the ΔE_i which are relevant are *not* the increases in the exports of the investing firms, they are the increases in *total* British exports. Since the exports of the investing firm may increase at the expense of the exports of its British competitors, the estimates of the ΔE_i provided by the applicant may well be entirely misleading to the authorities.

There is also the problem of defining precisely what is meant by the ΔE_i . Since ΔE is dated and the dating is crucial in [2] some dynamic process is obviously envisaged. Moreover, it is clear that the ΔE_i , to have any meaning, must be the increase in British exports attributable to the single investment I_r alone. They are, in

other words, an example of a *ceteris paribus* effect. It follows, therefore, that to obtain meaningful estimates of the relevant ΔE_i we need to be able to say by how much exports would have risen (or fallen) if the investment (I_r) had *not* taken place. This implies a quantitatively estimated dynamic model of both the investing (borrowing) country and the rest of the world. This, obviously enough, is not available. It is, however, a sobering thought that, even on restrictive assumptions, to obtain worthwhile estimates of the ΔE_i requires us to know not only the values of the parameters of the demand and supply functions of the static model of [14] but also the time form of each response (21).

In view of all this it seems that the authorities, in applying criteria [1] and [2] must, at least implicitly, be making some strong assumptions which enable them to use the ΔE_i of the investing firm as estimates of the ΔE_i of the economy as a whole. Assuming that this is the case, though in no way arguing that the procedure is justified, we can now examine the information, arising out of the Southampton enquiry, which throws some light on the value of λ and the ΔE_i for the investing firm.

Our enquiry covered 112 European subsidiaries. Of this number only 24 made any expenditure on capital account on equipment imported from the United Kingdom. Among these the proportion of capital expenditure devoted to the purchase of British equipment varied from less than 10% to over 76%. A crude average for the sample as a whole — assuming that 88 subsidiaries spent nothing in this way — would be between 5-6% (22). If this result is reliable it follows that λ is of the order of 0.06.

As regards recurrent exports the question was asked:

"Has the establishment of your Western European enterprise
reduced
increased
or left unchanged

the exports of (a) finished goods (b) semi-finished goods to the country
concerned by the U.K. parent or associated company?"

(21) According to the Southampton enquiry U.K. exports of finished and unfinished goods to European manufacturing subsidiaries amounted to nearly £8 mns. in 1962. These exports represented some 9 per cent of the net assets of the U.K. subsidiaries and associates in Western Europe included in the sample.

(22) This average is not weighted by the value of investments.

Clearly, in so far as the establishment of a subsidiary in one European country increases (or reduces) exports to other European countries the answers may be misleading. Equally clearly the firms are being asked to estimate the *ceteris paribus* effect of their overseas investment. The extent to which they can do this obviously depends on the extent to which they can say, with confidence, what would have happened to the exports of the parent company if the investment had *not* taken place. This question is a difficult one for any firm to answer and it may well be that what firms have recorded is the change in exports (as defined) which *followed* the overseas investment. Since the export experience of any firm depends upon a large number of variables other than its overseas investment, in so far as firms, in perfectly good faith, have based their replies on observed changes, their replies will be conceptually irrelevant. Moreover, there is at present no means of knowing whether this method over or under-estimates the response of the exports of the parent company to the establishment of an overseas subsidiary.

The available data is set out in Table X.

TABLE X

THE EFFECT ON EXPORTS OF PARENT COMPANY AS A RESULT OF INVESTMENT
IN EUROPEAN MANUFACTURING

%	E.E.C.				E.F.T.A. & Other				All W. Europe			
	Finished Goods		Unfinished Goods		Finished Goods		Unfinished Goods		Finished Goods		Unfinished Goods	
	Increased	Decreased	Increased	Decreased	Increased	Decreased	Increased	Decreased	Increased	Decreased	Increased	Decreased
0-10	8	4	6	1	0	3	0	1	8	7	6	2
11-25	3	1	0	0	0	1	0	0	3	2	0	0
26-50	3	1	0	0	1	0	1	0	4	1	1	0
51 & above . .	4	9	8	4	0	1	0	2	4	11	8	6
Unchanged . .	10		10		4		5		14		15	
Total no. of firms	18	10	15	14	10	5	1	4	5	19	14	20
	43		29		10		9		53		38	

In view of the arguments set out above the data in Table X must be treated with extreme caution. They serve only as a very approximate indication of firms' estimates of the *ceteris paribus*

effects of investment on their own exports. These estimates may be good or bad. They may also be biased since, in formulating them, firms may, in perfectly good faith, tend to overestimate. Thus warned we may now look at Table X.

The first question we can ask is whether investment overseas seems to be associated with a *change* — favourable or unfavourable — in the exports of the investing company. On this issue we have 91 observations, and changes were reported in 62 or roughly two-thirds of all cases. In this connection it is worth noting that while "no change" in exports was reported in the E.E.C. in 20 out of 72 cases, it was reported in 9 cases out of 19 in E.F.T.A. Variation in export performance appears therefore to be more commonly associated with investment in E.E.C.

The second question relates, of course, to the *direction* of change in exports. For all Europe, 34 observations show an increase and 28 a decrease. Moreover, while "finished goods" exports fell as often as they rose, exports of "unfinished goods", as one might expect, increased nearly twice as often as they declined. Neglecting value weights, there seems to be a tendency for overseas investment to be associated with an increase in the exports of "unfinished goods" by the investing parent. Here again experience in the E.E.C. differs from that of E.F.T.A. In E.E.C. 32 firms out of 72 reported increases (44%): in E.F.T.A. only 2 out of 19 (10%). Conversely while 20 out of 72 firms reported declines in exports in E.E.C. (28%), the proportion in E.F.T.A. was 8 out of 19 (40%). It seems fair to conclude that, so far as the sample is useful, in E.E.C., on balance, the exports of the parent company tend either to rise or remain constant after overseas investment (52 cases out of 72) while in E.F.T.A. they tend to fall or remain constant (17 cases out of 19).

It is not difficult to think of reasons why experience in E.E.C. and E.F.T.A. should differ including, of course, the industrial pattern of U.K. investment in the two areas as reflected in our sample. It is, indeed, so simple to think of hypotheses and so hard to offer any evidence either for or against them that we shall leave this apparent difference "unexplained", merely recording that our sample, small and unrepresentative though it is, suggests that there *may* be a real difference to *be* explained. Moreover, it is possible that any serious attempt to discover whether the apparent difference is real or not, and to explain it if it is, would throw further light on the relation between exports and direct overseas investment.

Though Table X suggests that overseas investment is, in general, more commonly associated with an increase in the exports of the parent company than a decrease, the rough mean of percentage decreases reported exceeds that of increases. It appears therefore that the net effect on the exports of parent companies — assuming that the returns correctly identify the *ceteris paribus* effect — could be small or even negative. This is confirmed by a rather crude estimate arrived at by weighting the percentage increases/decreases reported by the firms by an estimate of their export sales for 1962. Unfortunately not much reliance can be placed on this exercise. All that can be said is that the results of our enquiry do not establish that investing firms as a whole experience large net increases in exports.

One point which deserves mention is that those manufacturing parent companies which have set up *non-manufacturing* subsidiaries in Western Europe claimed very considerable export increases. In our enquiry 15 parent companies gave information on this point. Of these, 14 reported export increases — 10 by 51% or more of finished goods — while 12 of these also reported an increase in exports of unfinished goods. This is, of course, a perilously small set of observations from which to draw conclusions. It seems possible, however, to infer from this evidence that, in Western Europe at least, it may be investment in marketing subsidiaries which offers the greatest prospect of a high rate of return in terms of foreign exchange. This is a point which should be pursued in further research.

In view of the conceptual shortcomings of our data, the limited and possibly biased response by firms and the poor coverage of our enquiry nothing can be said with any confidence of the effect of overseas investment on exports. As our earlier discussion shows, however, this is a problem which requires, as a matter of some urgency, a more careful and systematic theoretical and empirical study than we have been able to give it in this paper.

8. Conclusions

The principal conclusion of this paper is that while the official and other data available make it possible to give a fairly comprehensive statistical description of British direct investment in Europe, it is not yet possible to make any confident judgment on the costs

and benefits of such investment. This, of course, is the case for overseas investment as a whole.

The present impasse arises because though the average rates of return, after foreign tax, appear to be less than the domestic rate of return, gross of tax, it is not at all clear that the former is an acceptable estimate of the marginal social product of investment overseas or the latter of the marginal social product of investment at home.

Because of the current weakness of the U.K. balance of payments position it seems that, in considering applications to invest outside the sterling area, the authorities now have primary regard to the rate of return (in terms of foreign exchange) which any investment is likely to provide and the "pay off" period of the foreign exchange expenditure.

As we have seen, the difficulties of estimating these are, in theory, greater than the difficulties of estimating the marginal social rate of return since they require the specification of a dynamic model. Certainly the data the authorities employ to form their judgments, which appear to be the profit and export forecasts of the applicant firms, are not necessarily of any obvious relevance to the social decision. Hence, the review of past forecasts, foreshadowed by the Chancellor, though possibly throwing some light on firms' forecasting abilities, will not, necessarily, be a good guide to the correctness of earlier official decisions. Nor are the claims of increased exports by firms investing overseas necessarily of much relevance either. In these circumstances the authorities, who cannot avoid the task of making a decision, are scarcely open to criticism for adopting the criteria they have. Not until there has been far more research and a systematic attempt to estimate the parameters of a model which is believed to be relevant and is accepted as such can more useful criteria be developed.

Finally, it seems arguable that the very differing experience, in terms of apparent profit, of British and U.S. investment in Italy should be the subject of a separate investigation. It is difficult to believe that an analysis of the widely differing results obtained by U.S. and U.K. firms would not throw some useful light on the relative managerial skills of the two groups and, in particular, on their choice of investment opportunities.

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