U.S. Direct Investment in the United Kingdom and National Economic Objectives *

Introduction

This paper poses two questions. First, what is the contribution of U.K. subsidiaries of U.S. firms to U.K. economic welfare and, second, what action (if any) might the U.K. Government take — either unilaterally or multilaterally — to ensure that the net benefits of this contribution are maximised? We propose, first, to make some general observations on these two questions, and then to illustrate our argument more specifically by reference to the impact of U.S. investment on U.K. technology.

1. National economic objectives

For many years now, U.K. Governments have had two primary economic goals — the maximisation of real output from the resources available (at any given moment of time); and the advancement of real output per head (over time). Governments have also pursued certain non-economic objectives — e.g. the maintenance of a certain amount of national political and economic independence, and, in the field of social welfare, adequate provision for the less privileged. But to the extent that the realisation of these aims require the use of scarce resources, they may affect, one way or the other, the success of economic policy. Likewise, there are various practical constraints on the primary economic objectives being achieved, e.g. the balance of payments. But, important as many of these may be in the short run, over a longer period of time their consequences,

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for good or bad, are reflected in the gross national product (g.n.p.) or rate of growth of g.n.p.

In this paper, we shall consider only the two primary objectives. This is not to ignore the importance of the others, but simply to contain our argument within reasonable limits. Moreover, our purpose is to assess the contribution of U.S. financed firms which is due specifically to their association with American companies — i.e. their "American" effect.

The problem can be broken down into two parts:

1) What has been the actual contribution of American investment in the past — and what might it be in the future *within the framework of past or existing Government policy and institutional arrangements?*

2) An estimate of whether this contribution has been (or is likely to be) the "first best", or optimum contribution to U.K. economic welfare. This implies both estimating whether U.S. subsidiaries have been as socially productive as they might have been, and whether or not the resources used by such firms could have been better deployed elsewhere.

2. How far have U.S. firms advanced U.K. economic objectives?

A. *As judged by the actual contribution*

The current Board of Trade survey on foreign direct investment in the U.K. conducted by Max Steuer (of the L.S.E.) and his colleagues will shed a great deal of light on the operations of U.S. (and other foreign) firms in the U.K. It would be wrong of me to give his statistics, so far unpublished, at this stage. I can say, however, they are broadly corroborative of earlier research on the subject — or, at least, consistent with the trends revealed by such research. May I just summarise these in a paragraph or two.

1) *Resource utilisation.* Directly or indirectly U.S. firms have added to total employment in the U.K. In the less prosperous areas of Wales, Scotland and North East England it is estimated they are currently providing jobs for about 125,000 people, who would otherwise have remained unemployed[1]. We calculate that this has added about 0.3% to the g.n.p of the U.K.

1 Assuming existing Government policy.

2) *Resource allocation*. Not only does U.S. investment tend to be concentrated in more productive sectors of the U.K. economy. Such evidence as we have suggests that where they compete alongside U.K. firms, American subsidiaries do better[2]. The mean (total) productivity differential in the mid 1960's was about 20% - equivalent to another 0.6% of g.n.p.

3) *Growth of output*. The share of U.S. subsidiaries in the g.n.p. of the U.K. is increasing. In 1957, about 5.7% of the sales of manufacturing industry were supplied by such firms[3]. By 1966 this had risen to 10.5%: today the figure would be near 14%. Most of this expansion has been within U.S. firms already operating in 1957. Between that date and 1967, the net assets of the largest 100 American manufacturing subsidiaries in the U.K. more than doubled, while those of the leading U.K. public companies rose by only two-fifths. In the research-intensive sectors, U.S. firms grew nearly four times the rate of U.K. firms. In most, but not all, industries, U.S. firms have maintained or expanded their share of the local market.

Our time series data are insufficient to allow us to make any *productivity* growth comparisons, but until the mid 1960's at least, this favoured American subsidiaries — even though, relative to their indigenous competitors, their profitability was falling[4].

Such figures as these, though quite suggestive, do not measure the impact of U.S. firms on the U.K. economy. Before one can do this one has to overcome two almost intractable problems.

One is to assess the "externalities", "spillover" or "spin off" effects of U.S. firms on national output — i.e. their impact on the resource utilisation and productivity of economic agents other than themselves: the other is to identify the extent to which their contribution to national prosperity is specifically due to their *American* ownership. On both these questions, there is a great deal of piecemeal evidence, hearsay and casual impressions. But, in general, the data are impressive enough to suggest that the dissemination of knowledge and entrepreneurship by foreign firms (particularly those

2 In 1963, of 23 industrial groups, *foreign* firms had a higher labour productivity than U.K. firms in 18 cases.

3 J. H. Dunning, *The role of American investment in the British economy*, Political and Economic Planning, Broadsheet No. 507, Feb. 1969.

4 J. H. Dunning, *op. cit.*, p. 131.

of American origin) is one of the most valuable contributions they have to make.[5]

As we have described elsewhere,[6] such a contribution may be *vertical* — i.e. affecting suppliers and customers of U.S. firms; or *horizontal* — i.e. affecting competitors — regional or industrial. More generally, knowledge and ideas are spread by the mobility of personnel, by the informal interchange of ideas among executives and by the publicity of various management and administrative practices. However much it may be possible to protect innovations in product or process technology, advances in "human technology", e.g. in management marketing, labour relations and capital budgeting etc. are very difficult to keep quiet. In a variety of ways such as these, U.S. knowhow penetrates the U.K. economy. No less important is the added competitive stimulus promoted by these subsidiaries, the parent companies of which are among the industrial leaders in the U.S.

Most of these gains reflect the advantages which U.S. subsidiaries derive *because* of their U.S. associations — or, at least, because they are more closely identified with the American industrial machine. Of course, not all such productivity can be so attributed. In some cases, size is an important consideration; size not only of the subsidiary but also that of the parent company. Another factor is the organisational structure of the multinational enterprise of which the subsidiary is part — for example, the extent to which its foreign operations are closely integrated and harmonised. However, one has to be careful not to take this argument too far, else one will explain away all the advantages. Equally, one must not ignore the drawbacks which might possibly arise from the American impact.[7]

Finally, even if it were possible to isolate and quantify the "American" impact, we would still be little the wiser about the comparative *efficiency* of U.K. industry *today*. Quite a lot of the current advantages U.S. subsidiaries enjoy arise from the economic

5 See e.g. D. Brash, *American investment in Australian industry*, Australian National Press, 1966.

A. Safarian, *Foreign investment in Canadian industry*, McGraw Hill, 1966.

A. Stonehill, *Foreign ownership in Norwegian enterprise*, Oslo Central Bureau of Statistics, 1965.

6 *American investment in British manufacturing industry*, Allen & Unwin, 1958.

7 J. H. Dunning, *The role of American investment in the British Economy*, p. 153 ff.

environment in which their U.S. associates operate or are the results of management decisions taken in the past.[8]

We conclude. Such evidence as we have suggests U.S. participation in U.K. industry has added both to the efficiency or resource usage, and the growth of output in the U.K. Making a "guesstimate" for the spillover effects of U.S. direct investment the g.n.p. of the U.K. is probably better off by 2-2½%. This assumes that in the absence of foreign direct investment, U.K. Government policy and institutional arrangements would have remained unchanged — a pretty tall assumption.

B. *Is this a first best solution?*

But is U.S. direct investment in the U.K. — or, more realistically, the present trend in U.S. investment — the *first best* way of realising the U.K.'s economic objectives? Two further questions now need to be answered.

First, are U.S. subsidiaries contributing the most they can to the g.n.p. (or growth of g.n.p.)? [9] If they are not, this may be because, either they are not operating at optimum efficiency, or because the share of the value added by them (i.e. net output) which is remitted to their parent companies (profits, dividends, royalties, etc.) — and hence the "price" which the U.K. economy has to pay for their presence — is, in some sense, too high.

Second, is the U.K. economy organised in such a way that the decisions taken by, and the behaviour of, U.S. firms will bring "first best" results?

Both these issues are very policy oriented, in the sense that Governments can affect their outcome. For, firms, both foreign and domestic, react to actions taken by Governments and apart from a withdrawal of investment (or reduction in new investment) their power is very circumscribed.

Maximising efficiency. — At any given moment of time, economic policy is a package of individual measures designed to achieve

8 This theme is further explored in J. H. Dunning, *Studies in international investment*, Allen & Unwin, 1970, p. 395-399.

9 Again, we omit from consideration the effects of such investment on the *distribution* of the g.n.p.

a variety of ends. Some of these measures — particularly those of macro-economic origin — are *general* and *unconditional*, in the sense that they are not influenced by inward investment — even though the need for them may be enhanced by it. An example of such a *general and unconditional* policy is one aimed at promoting a competitive environment. If, for example, there is a tendency for U.S. firms to promote a more monopolistic or concentrated industrial structure, then the case for such policies becomes the more urgent. Similarly, measures to deal with structural unemployment arising from innovations, rationalisation schemes and so on, become more pressing when multinational companies are organised on a geocentric basis, and seek to integrate their operations throughout the world.

If, however, it appears that there are certain differences in the behaviour of U.S. firms cf. domestic enterprises, then blanket type policies may be insufficient. In a different field, the general instruments used by the U.K. Government to maintain full employment do not fully meet the needs of certain geographical areas; these have to be supplemented by more selective and discriminatory measures, e.g. the regional employment premium. Similarly, because, as we have described, U.S. subsidiaries sometimes enjoy certain advantages (or disadvantages) over indigenous companies (because of their multinational links) — which, *inter alia*, may affect the competitive structure — more specific policies *may* be necessary to ensure that their contribution to the g.n.p. is maximised. This applies equally to the dissemination of knowledge and the effect on the efficiency of U.K. firms. One of our knowledge gaps is the size and character of the productivity "multiplier" of U.S. investment on the rest of the economy.[10] Here we could certainly benefit from a input/output matrix for U.S. firms in the U.K., though, as far as I know, none has yet been compiled.

There is another aspect of this problem to maximising economic welfare (in the limited sense in which we have defined it) which arises from the character of the operations of U.S. subsidiaries. Particularly among multinational enterprises in high technology industries, there is an increasing movement towards geographical product or process specialisation. This brings with it a new kind

10 For the concept of the technological multiplier see J. B. Quinn, *Scientific and technical strategy at the national and major enterprise level*. Paper prepared for the UNESCO symposium on *The Rôle of Science and Technology in Economic Development*, Paris 1968.

of economic interdependence between firms and industries, based on organising the global operations of a multinational enterprise in the most efficient (or at least, the most profitable) way. This has important implications for nations. Even if this process were shown to raise world economic welfare (and this, though probable, is by no means proven) it certainly does not imply that the g.n.p., in each and every country in which the multinational enterprise produces, economic welfare is advanced. If for no other reason, Government constraints on the free trade of goods and factor services would inhibit this. Hence, it *may* be that foreign firms choose to produce certain products or processes in the production chain which are less valuable to the host economy than some alternative and perhaps less specialised "package" of output. On the other hand, the U.K. may gain more than it loses by this form of international division of labour. One thing seems very probable; the way in which multinational enterprises organise their world production is likely to have increasingly important consequences on the economies in which they operate, and the implications of this for policy are quite extensive.

This argument takes us right into the core of the nation state controversy. I will not dwell on this save to suggest that *as the world is at present organised*, the maximisation of the *national* economic welfare and the freedom of the multinational enterprise to behave exactly as it wants, are, to some extent at least, inconsistent objectives. Moreover, I would suggest that the truth of this claim varies in direct relationship to the degree to which (a) a country is nationalistic in outlook [cf. for example, the attitudes of France and Germany towards foreign investment] and (b) foreign subsidiaries dominate economic activity (or particular sectors of economic activity) in host nations [cf. for example, the attitudes of the U.K. and Canada].

Sharing of output. — It is possible that even though they may operate at maximum efficiency, U.S. firms may not be benefiting the United Kingdom economy as much as they could, because the share of the output they produce which is remitted back to the U.S. is higher than it might be. The extent to which U.S. firms earn economic rent or surplus profits is dependent not only on the factors already mentioned, but on their ability to remit income by disguised means e.g. the manipulation of intra-group prices — not only of goods but of services. It is here where more *specific* Government policies may be needed to deal with the situation. Such evidence as we have suggests that there is not a great deal of "leakage" of income from the U.K. in this way, but obviously the possibility of the benefits of inward investment being eroded in this way needs to be kept under close scrutiny.

3. Towards an international approach

A. *The need for multilateral policies*

By contrast, it may be that the contribution of U.S. firms is not as much as it might be due to deficiencies in the host country's economic policy or institutions. To a certain extent, this is the situation in Europe today. The American challenge is serious, precisely because of the fragmented and unco-ordinated policies and inappropriate institutions of European countries to deal with their economic and technological situations. Or to give another example, rather than argue that inward investment should be curtailed where it is shown to result in an adverse balance of payments situation, it may make better economic sense for the Government of the host country to arrange its economic affairs so that this kind of effect does not matter.

In some cases, however, *bilateral* or *multilateral* policies may be required. For example, most issues of extra-territoriality involve investing and recipient countries, and can only be settled by *bilateral specific policies*. On the other hand, attempts to prevent recipient countries from using "unfair" practices with respect to encouraging (or discouraging) inward investment (hence driving up its "price") require *multilateral general policies*: so, indeed, may policies of investing countries to influence the dividend remittance and financing policies of its foreign subsidiaries.[11] Outside the economic sphere, there is a need for harmonisation of policy with respect to legal and accounting procedures. The concept of a "European" company is already firmly established; the idea of a "world" company is no longer a pipe dream. Accompanying this, there may well be need for a parallel to the International Court of Justice to deal

11 Witness the widespread effects on European capital markets following the restriction placed on U.S. direct investment by the U.S. Government in January 1968.

with international disputes arising from the operations of international firms.

Finally, mention should be made of a group of problems arising out of the international company, which only a sectoral unilateral or multilateral policies can resolve. Of these, the best example is of the attitude of labour towards the international company. There are two issues of particular importance here. First, trade unions may well seek for a general harmonisation of wage rates in all countries in which the company operates; second, there is the question of the effects of the operations of the international company on employment. Each of these issues could raise serious problems in the not too distant future; a glimpse of these is shown in the Trades Union Congress Economic Review for 1970.[12]

B. *Alternatives to inward investment*

There remains the question, "Could the benefits of U.S. investment be obtained better (i.e. more cheaply) by alternative routes?" This really is an exercise in trying to evaluate the opportunity cost of U.S. participation and/or different types of participation.

It may be asked why there is a problem? Why cannot market forces decide this issue? If the Government creates the right kind of economic environment surely decisions can be left to the private sector?

I think there are three reasons why this is not the case — and each reflects imperfections in the market. First, there is the relatively high cost of obtaining certain types of knowhow — and sometimes, of even knowing *where* to obtain the right kind of information. Second, at least part of the cost of producing knowledge (and we have already suggested that knowledge, in one form or another, is the most valuable commodity U.S. firms have to offer the U.K. economy) is financed by the public sector, where market considerations may be secondary to others. Third, there are important external social costs and benefits associated with inward investment which do not fully enter the calculations of multinational enterprises when deciding their investment programmes. For these

12 The issues in this section are further taken up in a prepared statement written by the author for the Joint Economic Committee of the U.S. Congress [Sub-Committee on Foreign Economic Policy], July 1970.

reasons, a cost/benefit analysis of inward investment and its alternative becomes necessary.

Let me give a very simple illustration. Suppose U.K. consumers are interested in obtaining a particular drug at present manufactured in the U.S. Several possibilities arise. The product could be imported: U.K. firms could produce it but import (by one means or another) the necessary technology: an American firm might set up a subsidiary in the U.K. to manufacture the product: U.K. firms might try and produce a similar product, using their own technology. Left to the market, it may be best for a U.K. firm to manufacture the drug, but buy the necessary technology through a licensing agreement. But this would not *necessarily* be in the best interests of the national economy. Compared with the setting up of a foreign subsidiary, the *direct* impact on the U.K.'s g.n.p. *may* be more favourable, but the technological spillover effects — which obviously the investing firm is not really interested in — could be much less; and though a new product would be added to the range of products supplied by the U.K. pharmaceutical firms, the technological dependence on the U.S. would be no less. For these reasons, host Governments may wish to intervene in the market process to tilt the balance towards inward investment.[13]

The question nevertheless remains; what kind of inward investment? The impact of the subsidiary of a U.S. firm — even within a particular industry — on the U.K. economy may differ considerably according to both the way in which it is financed and how its activities are integrated with those of the rest of the enterprise of which it is part. The technological spillover effects of a U.S. subsidiary in the machine tool industry may be no greater if it is 100% financed rather than 51% financed; but they may differ considerably according to the extent to which its operations are vertically integrated.

Nor is it possible to get very far with a macro cost/benefit analysis. By studying the ways in which different industries (or size of firms) obtain their technology and expertise, it may be possible to formulate general principles as to the conditions in which the subsidiaries of U.S. subsidiaries are most likely to max-

13 Alternatively, the market might overrate the net benefits of inward investment, and rather more constraints on foreign firms might be called for.

imise the g.n.p. of the U.K. compared with joint ventures or licensing agreements.[14] An obvious example is where the knowledge is of a kind which cannot be embodied in drawings, specifications, machines and so on, and is more concerned with management and organisational skills. Where, too, one wishes to inject more efficiency into a particular industry, the encouragement of inward investment may be preferable to propping up native firms by Government aid. On the other hand, where an industry is already largely controlled by foreign subsidiaries, a case might be made for Government help to assist domestic firms to compete more effectively. Sometimes, it may be in the best interests of a country to encourage a U.S. subsidiary to produce a complete line of products: in another to specialise and engage in the maximum amount of intra-enterprise trade in the world.

One, indeed, may go further by the use of this kind of approach to explain why certain *countries* have chosen one route to obtain foreign skills and technology — and others a different route. A thorough comparative analysis of the Japanese and West German situations since 1950 would prove very illuminating.

If the avoidance of U.S. domination of certain sectors of the U.K. economy is a key objective of the U.K. Government, then clearly all the other alternatives to direct investment have their merits — though it does not follow that these will allow the U.K. more economic *independence*. There is a lot of misunderstanding about the independence issue. It is true that international investment affects the geographical pattern of resource utilisation. But no less does international trade. For example, American enterprises have always influenced the level and structure of resource utilisation in the U.K. by their demands for factor inputs; in each case, the U.K. is economically "dependent" on the U.S.; the principles are essentially the same.

One thing does seem certain. If the multinational enterprise is to be an effective instrument for growth and efficiency, it does necessitate an economic climate in both host and investing countries which is receptive to the consequences of change. Like a country dependent on foreign trade, an economy in which subsidiaries of

14 Similarly, with the alternative forms of *outflow* of resources - though this paper has concentrated very much on the effects of the inward transfer of resources.

multinational enterprises play an important role, is more susceptible to the winds of economic change than one which is self sufficient. This is a price which, at times, and to particular sectors of the local economy, may appear a heavy one. Certainly this instability can be cushioned by appropriate Government policy towards redeployment and retraining, but it is a cost that any economy which seeks to keep pace with changes in world technology and conditions of demand has to pay.

4. Technology: a case study

It is difficult (and sometimes not very meaningful) to separate the various effects of inward investment, but, as technological advances are one of the main sources of economic growth, it is not surprising that attention has sometimes been focussed on this issue.

First, again a few facts. U.S. firms in the U.K. are concentrated in high technology industries and their share of the output of these industries is growing. The obvious advantage to the U.K. economy is the access to the research and development of the parent company and latest management techniques — providing that the price paid for such knowledge[15] is less than that for which they could be obtained elsewhere. The result of these benefits are shown in higher productivity and an accelerated rate of innovation, which, in turn, keep advanced the U.K.'s international competitive position. Certainly, one of the main reasons for the improvement in Europe's export of high technology products in recent years has been the increasing participation of U.S. investment. It has been estimated that these American financed firms accounted for one-third of the total increase of such products between 1955 and 1964.[16]

There are two main views about the technological impact of U.S. investment in the U.K. One is that it is all — or very largely — to the good. The basic premise upholding this view is that the permeation of new U.S. products and techniques throughout the

15 In the form of royalties, fees or profits.

16 J. H. Dunning, "European and U.S. trade patterns, U.S. foreign investment and the technological gap", in C. Kindlebberger and A. Schonfield (ed.), *The mutual repercussions of American and Western European economic policies*, Macmillan, 1970.

economy adds more to the g.n.p. than could have been obtained from any alternative use of resources, including payments made for this knowhow.

The other view, expressed most forcibly by the Ministry of Technology, emphasises two main dangers of this trend. The first is that the U.K. may become technologically too dependent on the U.S. to the detriment of her own indigenous research. The second danger is that, since the U.S. is herself a competitor to the U.K. in world markets, it follows that if she can obtain the fruits of U.K. research cheaply, then this could operate to the U.K.'s long-term disadvantage.

Where the balance lies between these two views can only be settled by the facts. These will differ, *inter alia*, according to both the quantity, distribution and efficiency of U.S. participation in particular industrial sectors. No general conclusions would seem possible. It is also necessary to distinguish short and long run effects.

However, let us make one or two general points before turning to some unanswered questions.

In principle, it should be possible to get some idea of the value of the technology — including management technology — imported from the U.S., in relation to the price paid for it. One does not pretend this would be an easy thing to do, but a broad "guesstimate" should be possible. What is much more difficult is to calculate whether this is the "first best" solution to obtaining the technology in question — assuming that it is thought desirable to buy the technology in the first place! I know of no comprehensive study which has attempted to assess the comparative advantages to the *host country* of importing technology through licensing agreements vis à vis direct investment.

It is also extremely difficult to evaluate the technological drawbacks to inward investment. There are, I think, two main issues. First, where a U.S. firm takes over a U.K. firm to gain its technological expertise, is it paying a fair "social" price for this, or is it getting the knowhow too cheaply? The word "social" implies that the value of the knowledge to the selling company may underestimate its value to the economy. Providing that it pays the price which will compensate the U.K. for any worsening of its competitive position (this has to be considered *net* of any gains consequent upon a reallocation of its research personnel, if the research of the U.K. company is disbanded) then this can be treated as a straightforward sale from the U.K. to the U.S.

The second issue is the control issue. This, in turn, has a number of implications. One is that the U.S. may be able to influence the direction of technological activity in certain U.K. industries, including the methods of production, to its own advantage which might run counter to the U.K. interests. It also suggests that the U.K. may well be technologically dependent on the U.S. and, because of this, lose a certain amount of its economic sovereignty.[17] This latter argument is part of the economic nationalism debate, which cannot be resolved in economic terms only. The best the economist can do is to estimate the costs (if there are costs) of this particular viewpoint.

On the question of the *direction* of technological activity it is possible to envisage situations where a subsidiary of a U.S. multinational enterprise may not operate to the maximum net benefit of the recipient country. What the host Government then has to decide is whether it should try to influence the behaviour of such enterprises by specific policies of one kind or another, or to encourage other means of achieving the same result. This, of course, it cannot do without a detailed analysis of the appropriate costs and benefits.

5. Some unanswered questions

A lot of questions remain unanswered. Some are more important than others and there is disagreement as to the priority of these. We are still feeling our way on the subject of the impact of multinational enterprises on individual nation states. On the specific questions of U.S. investment in the U.K. economy the results of the current Board of Trade enquiry should greatly advance our knowledge on its actual contribution to the U.K. economy. But, I suspect much will still need to be done before one can assess that it is making a first best contribution. My hunch is that in the great majority of cases, it is coming pretty close to the mark

17 See H. Johnson, "The multinational corporation and economic welfare", in C. Kindleberger (ed.), *The international corporation*, M.I.T. Press, 1970.

but, as we have said earlier, there are other than economic issues involved.

On the specific question of technology, in my view what is most needed is a study, first, of the costs and benefits of alternative ways by which the U.K. might "buy" technology — including producing itself and, second, of the extent to which the U.K. economy is properly organised to take the fullest advantage of the technological contribution of U.S. and other foreign firms.

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Reading