

A COMMENTARY ON
JEAN-JACQUES SERVAN-SCHREIBER'S BOOK,
THE AMERICAN CHALLENGE

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I

The report of the United States balance of payments for the year 1968 provides the basis for this discussion of the USA-EEC financial relations, in a tentative reassessment of *The American Challenge*, the book by Jean-Jacques Servan-Schreiber.**

The figures show that in 1968 the outflow of capital from the USA to the EEC for direct investment was reduced little in volume below the average figures for the previous three years. This outflow was at its peak just when JJSS was writing his book, and the deficit in the American balance of payments had been a more and more critical issue for some years, but the problem was ignored by JJSS in order to stress his own argument about American direct investment in Europe.

In his opinion these investments are a threat to Europe insofar as they represent a "seizure of power," a "take-over" of the EEC industries, by the big American corporations. He warned his fellow-Europeans that before long "the third industrial power in the world, after America and Russia, could be not Europe but the American industry in Europe," and that the European economy and Europe itself might be tied to the American economy by links of economic dependence.

In trying to emphasize his point, JJSS wished to minimize the crucial issue that American investment in Europe has been generated and financed by the outflow of capital from the USA to the EEC. He insisted, "it is not that we are being inundated by an excess of USA dollars which the Americans cannot use" and that "the least known aspect of the American investment in Europe is its means of finance." Offering only a few puzzling figures for 1965, and highly dramatizing his point, he stated that "nine-tenths

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** Hereafter referred to as JJSS for simplicity of reference

of the American investment in Europe is financed from European sources, with European money that our businessmen do not know how to use. In other words we pay them to buy us."

If this were the case, what about the menacing and persistent outflow of American capital registered for the last few years on the United States balance of payment destined for Europe? Would this American capital be wandering till the day of Judgment in the Atlantic Ocean like the Flying Dutchman, frightening everybody and getting nowhere, certainly not to the EEC? Apparently JJSS tried to doom it to that destiny because it did not fit in his picture. To deny this large, persistent flow of capital across the Atlantic from the USA to Europe meant denying what has been since the early sixties one of the main factors in the deficit of the American balance of payments; it implied denying what has been (owing to the most serious disfunction of the present international monetary system) one of the main threats to western world monetary stability and particularly, to the USA-EEC economic relations.

As a matter of fact, just at that time when JJSS formulated his famous warning against the potential threat of the American investment because it might result in a link of economic slavery tying the EEC to the USA, the very actual threat was just in the opposite direction; it was the threat of the American investment indirectly leading to the eventuality of the economic and financial links between the USA and EEC being loosened or even cut. Let us see the reason for this. We can say with William Martin, Chairman of the Board of Governors of the Federal Reserve System, that already at that time the USA deficit reminded everybody of the man who came to dinner, and though invited, stayed too long. And so did the European surpluses. Both had become chronic and shown a tendency to increase.

Meantime, partly because of these outflows, the dollar had become the world's major reserve currency and the USA had become the bank for the rest of the world. The European countries, as depositors looking to funds held in reserve by their banks, started to worry when they saw the USA reserves declining; then they started to request the USA to maintain a more reasonable relationship between reserve and liabilities, to put a stop to the deterioration of its liquidity position threatened by the decline in the gold reserve and the expansion of liquid liabilities. In other words, they were requesting the USA to cut the deficit in its balance of payments. At the same time they were complaining about the

inflationary trend of the American financial and monetary policy because they thought it was at the origin of the outflow of capital, and because they regarded this outflow as a vehicle for exporting the American inflation to Europe.

In late 1964 and early 1965 the current of American capital for direct investments in Europe had reached a peak level, primarily because of large and anticipatory outflow which had been the result of fears of restraints and controls over transfer of funds for investment abroad. In the autumn of 1965, President Johnson, worrying about the mounting pressure on the dollar and the gold reserves, invited American corporations to cooperate in a program of voluntary restraint, a program which was aimed at promoting the use of foreign rather than American sources to finance the growth of their affiliates in Europe.

Soon after this American move, JJSS started writing his book. The main aims of this program, to get the American investment in EEC financed by European sources, contributed in the best way to making his preconceived thesis plausible; but he took the result of the program for granted, and he even anticipated this in the past and figured it out in terms of the famous nine-tenths of the total American investment for the year 1965 financed from European sources. Had that been the case, what were Europe and Washington worrying about in that same year (1965) and why was that warning issued to the American corporations?

JJSS was also a bad prophet. The program did not work. According to the figures published by the *Survey of Current Business* for the years 1966 and 1967, the outflow of capital was not reduced but only its annual rate of increase slowed. At least one-fourth of the funds financing the investment of the affiliates of the big American corporations, continued to come from capital transferred from the USA. For over one-third, the funds still came from internal sources, from earnings retained in larger measure than usual, and from higher depreciation charges. Use of foreign sources became more frequent, however, yet for all this period, the American corporations financed their affiliates within the EEC, for not more than one-third of their needs, with funds borrowed in Europe, primarily issuing Eurobonds on the Eurodollars market; furthermore, they normally used no more than one-third of borrowed funds and put back the rest on the Eurodollar market as short-term funds. These figures do not compare at all with JJSS' figures.¹

¹ The confusing fact could have been that since the year 1965 the most important single factor in the Eurodollar market (and by far) has been the

On January 1, 1968, President Johnson announced a new program. This included mandatory restraints on direct investment abroad and tighter measures restraining foreign lending by banks; all these measures were plainly aimed at hitting more specifically the surplus countries of the EEC. Outflow of capital to these countries was to be stopped and all earnings were to be sent to the United States. As far as the international monetary equilibrium was concerned, however, the American program could be successful only if the reduction of the USA deficit in the capital account had as its counterpart a reduction of European surpluses in the current or in the capital accounts. The United States was committing itself to cut the outflow of capital, but was requiring the EEC countries to find ways to export capital in an amount equal to their merchandise export surplus or else they had to try to increase their imports.

The reaction to the program was rather sharp. The EEC countries, in a contradictory way now tried to ignore the balance of payments issue, while stressing the importance of the American investment as an integrated part of their national programs for the industrial renovation centered on fast-growing sectors, and asserting that an abrupt curtailment of such investment would jeopardize their national economic development. The American corporations vigorously protested against a program which threatened the strangling of their affiliates within the Common Market and got busy looking for devices to overcome the dictate.

As it happened, the Presidential decision was just in time. It had been hastened by the international monetary crisis of November, 1967, which had resulted in the devaluation of the pound (and in worsening the already precarious position of the dollar). It came just before a new international crisis which suddenly developed scarcely two months later as a result of the flight from the dollar into gold and which directly threatened the gold-dollar relationship. A hurried compromise solution, the two-tiers expedient, was agreed upon as an interim answer to prevent the eventual collapse of the international monetary system.

use made of it by major U.S. banks with branches in Europe. These branches started to place short-term dollars in head offices for the purpose of helping them adjust their money positions in response to changing needs for funds. U.S. banking sources suggest a quarter of the 25-30 billion dollar pool of the Eurodollar market has been flowing back and forth between Europe and the USA through that banking channel. (First National City Bank, New York, *Monthly Economic Letter*, October 1968, and *Wall Street Journal*, February 4, 1969)

The mutual bluff, as Professor Triffin called it, had been carried just short of the showdown. The bluff from the European side of the Atlantic, the threat to convert all the available dollars into gold to get an increase in its official price, and the bluff from the American side of the Atlantic, to suspend gold payments and to get off gold, both had been stopped only at this critical point. The increase in the gold price Washington could not have accepted because it implied devaluation of the dollar, loss of prestige, and break of faith with nations holding dollars. It would have resulted either in international inflationary tendencies, in case of a noticeable increase, or in expectations for further increases, in case of so small a rise that the problem of the international liquidity shortage would have been solved only temporarily, and it would have appeared as a first step towards demonetization of gold.

But such a solution the EEC countries might well have rejected for themselves because their central banks since the late fifties have had so much hoarded gold that they would certainly not look forward to seeing gold demonetized, and because their vested interests in gold were simply too great for them to accept any early change in its role in the monetary system. It is not difficult to envision the various potential threats involved in a situation such as this, the worst of all being the eventual partition of the international community of the IMF into two halves with the USA on one side (and the UK possibly joining the group of countries following a dollar exchange standard) and on the other side the EEC and other countries favorable to maintenance of the gold exchange standard. In other words, we escaped from a threat of disruption of the system that since the end of World War II had provided the monetary framework for an unprecedented expansion of world trade, and the risk of going back to the confusion of the thirties when the USA and UK "got off gold" while the Continental countries stuck to it, and when the prohibitive protectionism and competitive currency devaluation deepened and prolonged the Great Depression.

With respect to the Johnson program, the American balance of payments for the year 1968 shows that not even this scheme has worked properly, because even though it may have checked the rise in the outflow, it did not succeed in cutting substantially the flow itself. At the same time the balance of payments shows a large increase in the EEC countries' export to the USA to an extent that the American surplus in the balance of trade with the EEC has been reduced to one-fifth of its 1967 level. The 1968 American balance of

payments, nevertheless, does present a sizeable surplus for the first time since World War II (as pointed out by the First National City Bank of New York), but it has been brought about by inflows of capital from Europe that are quite transitory.²

Officials in Washington have stated that there is no evidence that last year's result marks the onset of a more favorable trend in the American balance of payments. In spite of that, the American corporations which accepted the controls as a crash and temporary program, already urge an immediate return to complete freedom; the new Republican administration has pledged "to bring to an end self-defeating controls on the investment at the earliest possible time" because they have proved costly, have created ill will abroad, and are contrary to the world's long-run interest in having scarce capital move to places where it can be used most productively; and the European countries already press for dismantling of the controls and insist on defining the measures as unjust, because, they remind Washington, their policies were always particularly favorable to American investors. Even JJSS advocated the continuation, for the time being, of the American investment as part of a crash program to reorganize European industry.³

The question is now whether the policy for adjusting the balance of payments will be relented. If this is the case and the outflow of capital should start again to rise and to contribute substantially to expanding USA liabilities abroad and to enlarging the American deficit, and should a new international monetary crisis develop on the issue of the dollar-gold relationship and become a threat to the two-tiers system, this will be regarded as

² For instance, "by the large repayments to U.S. banks of their loans abroad, but the fact cannot be duplicated; by bond issues floated in Europe by corporations in the USA, but they cannot be counted upon to run at levels as high as the rate recorded this year; by the exceptional amount of nonmarketable securities placed by the Treasury with friendly European governments and their central banks, but apparently they are becoming balkier about taking them; by purchases of U.S. common stocks operated by foreigners, in particular EEC nationals, but yet nobody knows if they may become increasingly solid or decline with the disappearance of the present political and economic uncertainty in the world." (First National City Bank, New York, *Monthly Economic Letter*, December, 1968).

³ JJSS writes: "in the short run, dependence is beneficial American investment... is the principal vehicle of technological progress for our economies... indirectly, it forces European manufacturers to a modernization they would have never accepted without that competition. If we permit American investment in its present form, Europe will share in the profits... That is an argument for a liberal attitude towards American investment... because, although an effort is being made to reorganize Europe's production, a long time will pass before getting to some results"

evidence that an overhaul of the present international monetary system must be undertaken. The USA and the EEC will have to decide what to do with it, because they can no longer cure it by resorting to the usual patchwork expedient.

To conclude on this point: JJSS, in order to drive his fellow-Europeans into realizing that if Europe is to survive, she must awake, unite, and react to the "American Challenge," resorted to the argument of the potential threat of the American investment eventually resulting in a link of economic slavery which could tie the EEC to the USA. But apparently the most urgent case, instead, is for resorting to the argument of the opposite but much more actual threat of these links between USA and EEC being loosened as a consequence of the malfunctions of the present international monetary system, in order to exhort USA and EEC to unite and cooperate in an appropriate balance-of-payment policy and in reforming that system before it is too late to avoid for it a sudden fatal crisis and the most damaging consequences, not only for the economic link in between the USA-EEC, but for the entire Western World's trade

II

The report of the USA balance of payments for the year 1968 also provides the basis for a second series of remarks on the financial problems of the USA-ECC economic relations. These remarks cover three major considerations: first, on disparities between environments, and precisely between capital markets in which American and European entrepreneurs operate respectively; second, on the alleged backwardness in the financial structure of the EEC enterprises, which, in the opinion of JJSS, makes them compare unfavorably with those of America and accounts in part for the famous technological gap between Europe and the USA; and third, on the integration of the EEC capital markets, which is referred to by JJSS as a prerequisite to his crash program for reorganizing the EEC industries.

The large amount of USA common stocks purchased by nationals of the EEC countries corresponds to one of the previously mentioned temporary factors which has brought about the dramatic shift in the American balance of payments for the year 1968.⁴ Since

⁴ According to the First National City Bank of New York, in the year 1968 the total purchases by foreigners—European for the most part—totalled more than 1.5 billion dollars, twice as much as in 1967, but eight times the 1966 figures. (First National City Bank, *Monthly Economic Letter*, December, 1968)

the early sixties, savings have been generated within the EEC national economies in a larger and larger volume and by now to an extent that the potentiality of the member countries as a source of capital is such that they could and should meet their own industries' needs and, at the same time, export part of their investable funds

As far as the export of funds is concerned, those purchases of American securities could appear at first, from the monetary angle, as the outflow of European capital which was requested in President Johnson's 1968 Program as the counterpart of the American reduction of the outflow of dollars, in order to reduce at the same time the EEC surplus and the USA deficit in their balance of payments. But this outflow of European savings to the USA appears to be the result of a trend too temporary to be expected to offset for long the much more likely persistent outflow of American capital to the EEC; too contingent a trend even to be thought of as an offset for the short transition period in which JJSS's "crash program" allows the American investment to continue in order to speed up the reorganization of European industries and to counterattack the American invasion. JJSS, however, does not worry about the monetary problem and in this case, too, it appears that he intentionally ignored it. Of course, from his point of view that the American invasion is going to result in a taking over of the EEC industries and in a seizure of power (that is, from the angle of a balance of investments between EEC and the USA), the European portfolio investment could never be the counterpart of the American direct investment.

These considerations lead to an examination of the second point concerning the resources which are supposed to meet the needs of the national industries in the EEC member countries, and which even JJSS acknowledges are plentiful. He complains, however, that in no one of the different countries are the national enterprises capable of using them and points out that on the average the big American firm has twice the capital assets of a comparable European firm and that this difference is particularly noticeable in the most technologically advanced industries. This is the reason, he says, that the former can easily raise money on the American capital market while the European enterprise, because of its weak financial structure, is not able to obtain the funds on its domestic market. (Currently the issuance of common stock within the EEC remains static.) For this same reason, he continues, the affiliates of big American corporations can go also to the European markets and

raise money, in competition with the European enterprises, and have "nine-tenths of their investment in Europe financed from European sources with European money that our businessmen do not know how to use."

This reasoning is the basis for his proposed crash program, which gives absolute priority to a series of mergers between the most efficient national enterprises of the different member countries' technologically advanced industries. The resulting EEC-based corporations, with an EEC statute, will be of such size, he concludes, as to make European industries able to compete as equals with corresponding USA industries and ultimately to counterattack the American invasion. "But a business of international scope needs an extensive market to provide it with capital; there will be incongruity and conflicts between a business of international scope and a financial market that is purely national. If European industry wants to compete with American industry as an equal, European markets will have to be integrated." This emergency program is meant by JJSS to be implemented when the process of European political unification begins to move, and as a first stage of it.

If it is true that at the present moment the actual difference between European and American corporations lies in the fact that the former, contrary to the latter, are unable to obtain the funds they need on the domestic market, what accounts for this difference? Is it that the weak financial structure of the European corporations compares unfavorably with the American, as JJSS asserts? Or, as is widely recognized, is it that EEC capital markets have a much weaker structure in comparison with the USA market?

If the latter is the case, another question is whether the integration of the EEC markets advocated by JJSS would also imply such modernization of their structure as to enable European entrepreneurs to raise funds on the integrated market to the full extent of their needs for reorganizing their industries; and at the same time whether this integrating process can go far and fast enough to ensure such a "crash integration," as required to implement the "crash program" for the EEC industries' reorganization.

As far as the first question is concerned, no one can deny that within the EEC national economies savings are generated to an extent that potentially all the member states could and should meet all the needs for expansion of the national industries, but no one can even deny that these large potentialities cannot be and are not fully put to use because of the inadequate and backward structure of the EEC capital markets. A large part of these resources do not

even pass through such markets, and consequently they suffer from shortage of supply and have not yet been able to meet the domestic demand for investable funds. Hence the reluctance of the enterprises to go to the market, and, as JJSS points out (though with unsatisfactory arguments), a limited number of new issues is floated on the primary market, and only a modest volume of securities is traded on the secondary market. The small volume of trade, in its turn, partly accounts for the high costs of marketing an issue, not only of shares but also of bonds, on the EEC markets. These costs are higher than on a market such as New York's, where plentiful supply and modern facilities account for much lower costs. Furthermore, taxes on new issues are much heavier within the EEC, where governments discriminate more heavily between public bonds and corporate securities.

These are the reasons that, until the Interest Equalization Tax came into force in the early sixties, European enterprises went very often to the New York market to sell equity securities or borrow directly and that, since then, many European concerns have sold out to American groups instead of floating their issues on their domestic markets.

On the contrary, if the EEC markets are inefficient, and compare so unfavorably with the American market, the alleged competition to European enterprises by the American corporations' affiliates on the EEC markets appears as a limp argument. As a matter of fact, they do raise money on the Eurobonds market, but do not interfere at all in the activities of the EEC different national equity share markets, where the scarcity of investable funds is felt. They do not even interfere, indirectly, with the different national bonds markets, where the volume of funds passing through is instead more than adequate, because these funds are properly channeled by specialized credit institutions which govern them and not substantially reduced by the flow of funds diverted to the Eurobond market.

This backwardness of structure on the side of the supply of capital, is particularly serious on the EEC equity shares markets and badly affects the whole saving-investment process in all the member countries. The reluctance of the individual savers, for instance, to invest on the long-term corporate securities markets, especially on the equity shares markets, is common and traditional to all the EEC countries. The very sad experiences the individual saver had with the large European inflations or confiscations during the years immediately after World Wars I and II have made him so sensitive to dangers such as those that now the current political

and economic uncertainties cause him to buy American securities and believe that the USA is a safer depository than Europe for his funds.⁵

This deficiency of structure on the EEC equity shares markets, however, is the result not so much of the individual saver's reluctance to invest as it is of the lack of institutional investors. This is the crucial difference which makes the EEC markets compare unfavorably with the American market. How much these institutions, when they effectively operate on the capital market, may affect the saving-investment process, is shown by the strong stabilizing but often bullish influence exercised on the American stock exchanges by insurance companies, pension funds, or other institutions, such as mutual funds or even nonprofit organizations such as colleges, universities, and foundations.

While it is very difficult to deny these institutional investors' stabilizing influence, it is not difficult to find evidence also of their bullish influence. The stabilizing influence of insurance companies and pension funds has always been a result of the investment pattern of institutions which dispose of funds corresponding to long-term liabilities.⁶ As for the bullish influence of these institutions, it has been more and more noticeable on the American market for the last decade, as a consequence of their faster accumulation of reserves.⁷ As far as the mutual funds are concerned, their invest-

⁵Secondary causes and only secondary causes are the considerations that the American economy provides better prospect for capital growth and that the USA offers an easier tax treatment under the Foreign Investor Tax Act of 1966. Undoubtedly the European firms' traditional habit of withholding full and clear information on their activities, performances, and prospects is an obstacle to a better understanding with the potential investors, but undoubtedly also this enterprise's behavior is only a secondary cause of this outflow to the USA, as it is in general also only a secondary cause of the saver's reluctance to invest on the domestic market. (International Monetary Fund, *Staff Papers*, vol. XII, 1965, Washington, D.C.)

⁶With respect to the American market, a recent analysis shows that insurance companies prefer to invest in stocks of long-run safe growth in value even if they give lower current dividend returns than other securities. (*Quarterly Review of Economics and Business*, October, 1968)

⁷In 1957 an amendment to the New York Insurance Law was approved, and since then insurance companies can invest in common stocks up to 5 percent of their total assets or 50 percent of their surplus. As a consequence suddenly in 1958 their annual stock acquisition rose by one-quarter and in 1959 again by one-third; for the last decade this upward trend has held firmly. In the same decade also, the performance of pension funds on the American capital market has been much more impressive than before. They have always been free of legal restrictions in their investment-in-equity share, but since 1959, company pension plans have been included as one of the largest items in collective bargaining agreements. At that time only a quarter of the working population was covered by company pension schemes. Since then the pro-

ment patterns account for their bullish influence because they are much more responsive to high dividends and total income return.⁸ According to a recent Big Board estimate, on the New York Stock Exchange all these institutions now account for approximately half of all trading.

What is the position within the EEC? All the member states of the EEC have some sort or other of regulations to prevent insurance companies and pension funds from investing in common stock and to compel them to direct their investable funds to public bonds market. As far as mutual funds are concerned, some of the EEC member states have not yet provided proper legislation to authorize their activities.

That is why, whereas on the American market issues and syndicates find ample outlets with mutual funds, insurance companies, and pension funds, on the EEC markets the weaker structure results in the lack of facilities for new introductions, and accounts also, at least partly, for the extremely narrow secondary markets. As JJSS points out, the American market handles a rich choice of thousands of titles, while only a few hundred are to be found

portion has been expanding very rapidly and the increasing investment potential of such funds has resulted in an upward trend in their activity on the capital market

According to the *Wall Street Journal*, pension funds in the USA had assets of \$84 billion at the end of 1967 and the assets are growing at a rate of at least 10% a year. Moreover, these funds want to show prospective pensioners impressive gains on their investments and so the tendency for them has been to put more and more money into common stocks rather than into alternative investments such as bonds. As a result the pension funds have increased stockholding to 60% of their net assets, from about 35 percent a decade ago at the eve of the new regulations for company pension schemes. In 1967 they put into common stocks 75% of the 7 billions of new money they had available for investment.

A recent estimate put the pension funds' current acquisition of common stocks at the same level as all individual purchases together. For years now, common stock purchased by insurance companies and pension funds has been about three times as high as simultaneous new issues (*Wall Street Journal*, September 28, 1968).

⁸ Nevertheless, their stabilizing influence has been lately proven again by an investigation of the Securities and Exchange Commission, which has shown that in periods of market decline the public buys more shares of mutual funds than are sold back to the companies. The *Wall Street Journal* reports that in the USA at the end of July, 1968, mutual funds had aggregate assets of at least 52 billion dollars against 18 billion ten years ago, and that their number is increasing very rapidly. At the end of 1966 the National Association of Investment Companies had a membership of about 350, but the companies registered with the Securities and Exchange Commission numbered at least twice as many; more than 75 new funds have begun operating in 1967-68, and at the end of 1968 another 100 were waiting clearance of their registration statements (*Wall Street Journal*, September, 1968).

on the EEC stock exchanges; but the reasons are not in the weak financial structures of European enterprises, as JJSS asserts, but in the weak structure of European capital markets.

These remarks lead to the next question: How fast and how far could the integration of the EEC market go, and how much modernization of structures could it include?

It is impossible to answer this question, but it is more important to try to understand the nature of the process than to try to predict where it will ultimately lead. Unfortunately, and contrary to the opinion of JJSS, the expression "integration" of the national markets of the EEC member states is not a kind of a magic formula which, as soon as it has been recited, makes things start moving and puts the new system to work. In a much more realistic way the expression denotes a very long, difficult, complicated, and unpredictable process which might eventually result in an actual interconnection of the six national financial systems.

The integrating process should be thought of, not so much in terms of harmonization of market structures as in terms of harmonization of government policies. Each of the six capital markets should be thought of as a structure of the national financial system, as part of an entity which is governed primarily by the economic, financial, fiscal, and monetary policies of the national state. Integrating the markets appears to be a matter of progressive coordination of the six national autonomous policies into a common EEC policy, of progressive relinquishment of sovereignty by the member states in favor of a supranational authority. In other words, and contrary to the opinion of JJSS, integration of the EEC markets cannot be thought of as an early phase of the EEC political unification, because the integrating process is indeed just an aspect of the most complex process of political unification, its stages are concurrent with the political unification phases, and its "tempo" and development cannot be faster and shorter than the main process.

An eventual first stage of the process toward integration was opened when a few years ago, for the first time, the six governments reciprocally committed themselves to relax part of the strict control they maintained on their national markets and decided on the removal of a series of restrictions which were specifically intended to prevent the free movements of capital between domestic and foreign markets.⁹

⁹ These are measures such as exchange controls, tax instruments to discriminate between investment made abroad and investment made in the

This first stage does not take the markets very far on the long way toward eventual integration. Still worse, that is all the Treaty of Rome calls for, because that stage corresponds to the present early phase of the federalizing process among the European states, and it does not imply at all some further steps, or refer in any other part to an integration of the six national markets.¹⁰

To enter the second stage towards the ultimate goal of integration, the governments of the member states should agree on furthering coordination of their economic, financial, fiscal and monetary policies; they should commit themselves to harmonize them to the extent that the six capital markets would be more homogeneous as far as interest and yield structures are concerned, and would have more similar rates and prices for comparable assets; they should accept full and free competition between the six capital markets. In this case the six governments should be prepared to surrender the most significant aspect of sovereignty in financial and monetary matters, should be ready to renounce the nationally autonomous policy of giving absolute priority to stability on the domestic market, and should commit themselves instead to a common EEC policy intended to maintain stability for the integrated area as a whole.¹¹

investor's own country to the detriment of the first, directives to national financial institutions or enterprises, and discrimination against foreign investors. Two directives were issued by the Community Committees which have freed direct investments, investment in fixed property, capital movements of a personal value, short-and-medium-term commercial loans, stocks and other shares trade on the National Stock Exchange, and other capital movements. (Krause, Lawrence B., "The European Economic Community and International Liquidity", in *Money and the International Order*, Dallas, 1964—OECD, *Capital Markets Study*, Several Reports, 1964, Paris).

¹⁰ At the moment, in the first stage of the process, the flows of capital for direct investment between the member states are so limited that in each of the six countries the aggregate annual inflow from the other five members of the EEC corresponds to not even one-fourth of the total foreign direct investments, whereas the American investment represents from 40 to 50 percent. (Institute of Statistics of the EEC).

¹¹ As far as measures of general economic, financial, and fiscal policies are concerned, the six governments should, for instance, eliminate all those disparities between their national fiscal and taxation systems which result in different yield structures on securities markets. Some of the member countries impose taxes on the issuing of securities (some countries more heavily than others); other member countries tax dividend and interest payments, and again each country with a different rate; all member countries maintain legal restrictions on financial institutions against holding debt-instruments of other community members. As far as direct measures of intervention are concerned (for instance, measures to influence interest structure), all of them should be coordinated in order to cancel disparities, from the most flexible affecting the volume of supply and demand, to the most directed involving maximum or

If the member states go as far as this second stage, however, they will no longer be able to stop the process short of the third stage of an actual complete effective integration, because a common policy maintaining stability on the EEC-wide market leads necessarily to a pool of reserves, a common central bank, and a common currency. This third stage would imply, too, some supranational political institutions and certain forms of political union among the member countries which are not yet within the range of the concrete possibilities for their common action. This is the reason that member states are not expected to speed up the process through its second stage, and probably are not even prepared to open this but are content with the first stage.

Even assuming that the process of political coordination would aim for the ultimate goal and eventually reach it, this result, by itself, would not be enough to make the integrated market work in the most efficient way and thus result in a mobilization of all the financial sources of the country and in the largest volume of investable funds passing through it. It would not be enough even if the process in any phase should include the harmonization of national policies on institutional investors' activities to the extent of a joint authorization by the governments of the member states to the institutions to operate on the equity-share markets.

Insurance companies and pension funds would not be very important acquisitions for the structure of the integrated EEC capital market, because their investment potential would stay rather modest. Within the EEC countries they are paralyzed in their growth because of the preponderant social security plans which, contrary to the American way, try to give complete protection¹²

minimum or single rates fixed by administrative decision. As a consequence, the advocated greater competition between markets could follow and there could be the possibility of a community-wide network of financial intermediaries with standard practices and costs. These mechanisms could undoubtedly be very effective in bringing together borrowers and lenders to facilitate flows-of-funds behavior in the markets (IMF, *Staff Papers*, Vol. XII, 1965, Washington, D.C.—OECD, *Capital Markets Study*, 1965, Paris)

¹² In all the EEC countries these institutions try to give complete protection and ask for individual contributions which are very large when compared with personal wages, incomes, and savings. The habit of contracting an insurance or a company pension plan is not so common as it is in the USA. As a result, on the continent neither insurance companies nor pension funds can accumulate large reserves as is the case in America.

In the USA, on the contrary, the social security system on a national basis is meant to give only a limited protection, individual contributions to it are not high when compared with wages and savings, nearly everyone looks for additional protection with insurance companies or company pension plans, and many have the funds to contract for them.

In regard to the investment companies, if the European savers' distrust for the domestic equity-shares market continues to result in reluctance to buy mutual fund shares, the authorization to these institutions to operate would be useless from the standpoint of a more efficient capital market.¹³

As far as the financial causes are concerned, the conclusion emerges, then, that at the root of the technological lag of the European Economic Community there is not so much the enterprises' incapability to obtain funds from the capital market, as an actual financial gap between the EEC and USA—a gap in terms of volumes of funds generated by the national economies and in the method of channeling such funds to the market. Unfortunately the European entrepreneur cannot hope to see this gap closed in the near future by a "crash integration" of the EEC capital markets, and without this crash integration, which could enable him to make a success of the "crash program" advocated by JJSS for reorganizing the European industries, he cannot even hope to be able to compete in the immediate future as an equal with the American businessman.

III

The American balance of payments for 1968 shows another interesting fact. The USA trade surplus with the EEC countries was reduced in 1968 to one-fifth what it was in 1967, from one billion dollars to 200 million dollars. This provides a cue for a third series of remarks on the problems of the financial and monetary relations between the USA and the EEC, which leads to some consideration of the environment in which American and European entrepreneurs operate respectively, and of the "managerial

Within the EEC, according to an article in *The Banker* not even the national institutions running the compulsory plans would constitute substantial acquisitions for the structure of the markets, because not even they have a large investment potential; in their case pensions are tied to rising wages, contributions tend to be too short to offset payments, and reserves do not accumulate very fast. At the moment the governments of the six countries seem not to be prepared to grant authorization to private or public institutions for operating on the equity-share market, despite a proposal by the EEC authorities to relax controls intended to direct their investments on the public bond market. (*The Banker*, London, February, 1968).

¹³ A further consideration as to the prospect of integration of the EEC markets, is the fact that governments of member states certainly are not prepared, and positively not allowed by the IMF to make of the integrated EEC capital market a sort of preferential area by limiting the internal convertibility of their currencies in order to stop the export of investable funds and compel them to be invested within the EEC.

gap" between them, the latter being one of the main arguments in the JJSS book¹⁴

The EEC countries have had better and better results for the last decade in their trade in all directions as well as in their trade with the USA for the last five years; their favorable balance of trade accounts for a substantial part of the surplus in the current accounts of their balances of payments, just as the inflow of capital for direct investment from the USA has accounted for the surplus in the capital accounts¹⁵ According to some American official sources, apart from the contingent factors,¹⁶ this upward trend in the EEC industrial export in every other direction, as well as the USA, must be attributed primarily to the competitiveness of traditional European industrial products¹⁷

The American challenge however, JJSS writes, has to be feared

¹⁴ The figures for 1968, compared with the figures for 1967, show an increase of 13% in American exports to the EEC but an increase of 36% in the EEC exports to the USA. As a result, the German surplus has increased five times, Italy's deficit has disappeared, Belgium's deficit has been halved (*Federal Reserve System, Bulletin*, November, 1968).

According to other figures on trade between the USA and the EEC, published by the *Survey of Current Business*, in the period from 1963 to 1968 Germany has succeeded in shifting from a deficit of 150 million dollars to a surplus of 250; Italy gradually eliminated a deficit of 500 million dollars; France has improved its position.

¹⁵ During 1962-65 export of industrial products from Belgium and the Netherlands expanded more rapidly in percentage terms than did industrial production.

In 1954-55 Italy's exports covered imports to the extent of only 71.9%, but by 1959 the percentage had risen to 95.6%; from 1959 to 1965 its industrial production increased almost 90% while Italian exports doubled; in 1968 Italian exports were 50% more than in 1965. Italian industries such as automobiles and electric appliances export up to one-third of their production; other industrial sectors, such as chemicals and machinery, export not less than one-fourth. (Federal Reserve Bank of Cleveland, *Economic Review*, December, 1968).

For Germany, the GNP in current prices increased from autumn 1967 to autumn 1968 at a rate of 8.5%, but exports, which constitute nearly one-fifth of the GNP, advanced in annual rate terms by 13% and accounted directly for one-quarter of the growth in GNP. (Federal Reserve System, *Bulletin*, November, 1968).

¹⁶ The rapid increase in American imports from the EEC during the past 5 years reflected the general buoyancy of demand and the rising prices on the USA inflationary market; as far as 1968 is concerned, the first stage of reduction in tariff negotiated in the Kennedy Round may have helped the EEC countries more than the USA, while several other and special factors affected merchandise trade between America and Europe, such as labor disputes in some American industries and at some harbors (*Ibid.*)

¹⁷ In Germany the rate of productivity gain attained from 1967 to 1968 was not less than 7%; in Italy during the 1958-65 period, industrial production increased almost 90%, while wholesale prices rose by only 13% (*Ibid.*)

in the field of the most technologically advanced industries. Another commentator of the same opinion writes that "Europe's concern about this challenge has been expressed sometimes in extreme terms, and that is that the USA is a machine uniquely geared to exploit the flood of achievements pouring from richly endowed laboratories of industry, universities and government; a machine with a high-precision education system turning out a swelling army of scientists [and] engineers, commercially ambitious, propelled by the aid of a benevolent Federal bureaucracy lavishly awarding R and D contracts and tax privileges to industry and thereby removing risks of the unknown; while cool, professional, venturesome managers, directing giant concerns, aided by banks and computers, are rationally forecasting the patterns of future technology and establishing the demand. And all this to capitalize on what is already the world's richest market."¹⁸ He concludes that "a description such as this is perhaps less a picture than a caricature." But, undoubtedly, as far as the USA is concerned, the large size of its economy, the natural resources endowment, the large capital supply, insured by a modern, efficient financial market, rank high as an explanation of the rapid pace of technological development; undoubtedly again, the growth of the American economy was achieved under conditions of labor scarcity which stimulated the large application of technology to the production process. All this has been contributing to a uniquely favorable environment for the American manager, and he has made the best of it. The European entrepreneur has been operating in a very different environment, but he too has been trying to make the best of the economic, social, and political conditions which face him.

In contrast with the USA's economic development, Western Europe's in the past, and particularly its faster-than-ever annual growth rates in the last two decades, have been primarily the result of a large expansion in the labor force, which has kept wages relatively low.¹⁹

The correlation between labor supplies and competitiveness of

¹⁸ Copisarov, A. C., "Building a Strong European Base in Science and Technology," XIX, *Table Ronde des Problemes de l'Europe*, Turin, 1967.

¹⁹ After World War II, while the European overseas emigration was greater than ever, Western Germany received large numbers of refugees from East Germany, the Netherlands brought back their settlers from the Dutch East Indies (by then independent), France welcomed back former residents in Algeria (no longer a colony), Britain was reached by Polish refugees, Irishmen, and then by Commonwealth citizens from Pakistan and West Indies, Italy registered the largest internal migration from the agricultural South to the industrial North; later on the Rome Treaty provided for free movement of labor within

the European products, on the whole incontestable, must not be construed, however, into a simple causal explanation; the entrepreneur must be taken into account as the third factor which helped in linking the two variables. Again, the role of the entrepreneur must be reckoned with when mentioning the EEC national governments' financial and monetary policies, which undoubtedly promoted, stimulated, and sustained the upward trend in exports of the EEC countries. Again in contrast with the USA, which has, for the last decade pursued an inflationary financial and monetary policy, labeled as Keynesian, the EEC countries have been pursuing since the end of the war, a "conservative" policy. Until last year this policy was criticized by Washington because it aimed at a larger and larger surplus in the balance of payments, and because it was proved to be as much responsible for the unbalanced international monetary equilibrium as the American policy, which resulted in a larger and larger deficit. This conservative policy has, by recurrent credit tightness, kept under control the growth of wages, income, and investments and checked the rise in imports (investment goods as well as consumption goods); it has moreover, by permanent discrimination in credit allocation in favor of export industries, promoted and sustained exports. As a result of this policy very large current account surpluses have been obtained at the cost of domestic expansion and of distorting the growth of the national economy. The narrowing of sale opportunities on the domestic market has led to intensified selling abroad.²⁰

JJSS writes that the science of marketing is unknown to the European managers. But what accounts for the success of the Volkswagen on the American market? To whom goes the credit for the accurate market research which resulted in proving the potential American demand for a car of this type?

the EEC and many Southern Italians went to Germany or France, then Greeks and Turks (their countries being associate members of the EEC) were entitled to the same privileges, and later Spaniards and Portuguese followed when special treaties gave them the same rights.

²⁰ The Federal Reserve *Bulletin* reports, for instance, that in 1968 "in Germany the upswing in production (6%) has not been accompanied by a proportionate rise in consumption (3%)" and that in Italy "industrial production was more than 5% above its level a year earlier . . . but most components of internal demand were relatively sluggish," and that "the record in the labor markets in Western Europe, moderate changes in employment and in wage rates in most countries suggests that thus far the expansion has resulted in only a small growth of disposable income. This partly explains the weak and limited contribution of private consumption to the upswing in most of those countries." (Federal Reserve System, *Bulletin*, November, 1968)

Again, as in the case of the German cars, what accounts for the success of many Italian industrial products on the American market? According to one of the Federal Reserve System *Bulletins*: "Italian export industries generally emphasize flavor, style, and imagination in product design and in large part this emphasis reflects a new generation of Italian businessmen that have been successful as managers and innovators as well as in achieving profitable operations. Many of these businessmen have established new, independent companies." According to the *New York Times* (of September 28, 1968): "Other entrepreneurs have renewed old companies with a science-based orientation;" FIAT's Agnelli "is American oriented in all matters of business" and "his drive for management techniques may eventually lead him to buy into an American company."

These two examples of German and of Italian entrepreneurs show that EEC industrialists are not, all of them, only and always on the defensive, as JJSS says in his book; they can be, on the contrary, most aggressive, at least in the sectors of the traditional industries. In these sectors the EEC industrialists have made the best of the domestic environment (large supply of cheap labor and favorable government policy), have made competitive their traditional industries' products on foreign markets, and at the same time have developed new methods of marketing which also account for the rapid increase of their exports. The expanding exports have been leading to higher profit and investment, and for the last two decades some of the European traditional industries, for instance metallurgy and chemicals, show more rapid technological changes and important innovations than the same American industries. Once again technological changes were directly responsive to market conditions and perceived profit opportunities.²¹

As noted before, JJSS, however, warns his fellow-Europeans about the threat of an American control of the most technological advanced industries in the EEC, about a technological gap widening faster and faster between the USA and the EEC, about the very hard and sad future which Europe will be approaching unless she unites and reacts to the American challenge. Europe will be, in his opinion, a second rate industrial power, with the subsidiary role of a satellite, in an alleged post-industrial era which is sup-

²¹ Not all the credit for the successful export drive, however, can be imputed to competitiveness. On foreign markets, and on the American market particularly, EEC industrial products in many cases have been sold regardless of prices: often they represent a better alternative in quality to the corresponding domestic products, or sometimes no alternative to them exists on the market.

posed to be open by the year 2000, thanks to the most incredible and surprising miracles of the newest technology. To emphasize his thesis JJSS puts in the picture not only this bit of "science fiction," but together with it even a bit of ancient history: the future of Europe is compared with the decline and fall of the empires of Babylon and Rome. At that point one begins to wonder whether Europe really has no other alternative.

What about a united Europe not worrying too much about "science fiction" and the unpredictable future development of society in a hypothetical so-called post-industrial civilization, but anxious for civilized industrial society in our times? What about a new Europe, united in a more effectively working EEC, challenging herself by implementing the Treaty of Rome through a "crash program" intended to solve her actually most serious problems by concerted action at the EEC level by coordinating the member states' economic policies and not by separate national initiatives? This is precisely what the Treaty of Rome calls for, and urgently, because those problems otherwise are likely to accelerate in the near future and indeed bring about the decline and fall of European civilization.

The Treaty of Rome preamble plainly states as the principal aims of the EEC as a whole "a continuous and balanced economic expansion, an increased stability, an accelerated raising of the standard of living," and again, "a common effort to speed up social progress within each country and then in an integrated Europe, through cooperation of all forces in the six countries," and "to promote the improvement of the living and working conditions of labour." The Treaty of Rome explicitly calls for a common policy by the EEC, and not for autonomous national initiatives, "to reduce the gap between the different regions and the backwardness of the least favoured," to reclaim the underdeveloped regions of Southern Italy, Brittany and the Southwest in France, the strip of land down the frontier with the East, in Germany, and the Ruhr—paradoxically the German area with the biggest problems because of the declining coal mining and steel industries—the depressed agricultural zone of East Flanders in Belgium, and part of Southern Holland. The Treaty of Rome does not refer specifically to, but implies other aims such as urban redevelopment programs, abolition of ghettos, and pollution-control plans.

Europe can pioneer in all of these fields, is capable of these achievements, and has the resources to start these programs. The European economy is not about to collapse, despite JJSS' assertions;

the postwar rate of economic growth, higher in many European countries than in the US, provides the proof.

Of course, if the EEC governments would join in giving absolute priority to the policies of domestic expansion, to redeeming underdeveloped regions, to leveling upward the living and working conditions, and yet at the same time maintain stability; then both the state and private economic initiatives and activities would need to be somewhat coordinated in this framework. Not even the international concern within the EEC should ignore the framework of the six governments' policies and if American corporate investments, as JJSS asserts, are to be continued for the time being, because in the short run they are beneficial to the European economy as a whole, their growth should not be an uncontrolled explosion. Governments and American corporations' affiliates should not content themselves with casual and spontaneous relations, but should have their relations institutionalized. In that framework, however, European and American enterprises actually would have better opportunities. Incentives would be provided to foster the growth of investments in every industrial sector along with the states' investments in the infrastructures, first of all in atomic energy power stations. Even part of JJSS' crash program could fit in this framework if only the member states' governments would at last agree on common EEC defense equipment, on common EEC airline equipment, and on common EEC advanced technological equipment for public sectors, in order to permit standardization of types of battle and civil airplanes, of computers and telephones. Also, JJSS' crash program would fit in if only the governments would agree to coordinate their purchasing policies and pool their procurement powers in order to encourage companies of the different member countries to form consortia to tender for contracts and eventually to merge in European companies.

A policy of domestic expansion such as this will require the mobilization of all the capital resources within the European Economic Community. At the same time it will stimulate the capital markets to the European Economic Community to such an extent as to improve the already efficient banking structure on the bonds markets for the channeling of funds particularly to meet state needs, and to make the more backward structure of the equity-shares markets modernize itself in the effort to meet the needs of private enterprise. As for the European consortia and companies, some sort of EEC agency, supported by the governments of the member states, might be established to insure risk capital at stake

in such projects. As for the American concerns, they might suffer for scarcity of funds because of governmental limitations on the outflow of capital from the USA, or because of the shrinking of the Eurodollar market as a consequence of the EEC countries' increased imports for their policy of expansion. In these cases they would have to go to the EEC's different national financial markets, and their requirements should be coordinated with those of the national enterprises, in the framework of financial policy. The big problem will be with the rate of interest, because a noticeable increase will hamper the growth of investment, while a low rate might lead to the export of resources. This export, owing to the needs of the new policy of expansion, should no longer be advocated; at the same time it would no longer be needed for adjusting the balance of payments, because the rising aggregate EEC imports will cut the surpluses.

The expansion drive should require a change away from the conservative financial and monetary policies pursued by the EEC governments: tightening of credit should no longer distort the national economic developments, and discrimination in the allocation of credit and resources should no longer be practiced in order to get a bigger and bigger surplus in the balance of payments. In that way, also, the international monetary equilibrium would improve, and if Washington, too, will decide on a definitive policy to cut down the American deficit, then EEC and the USA will be able to cooperate in order to set up a better international monetary system and to put an end to the old system of mutual bluff.

This "European challenge" would not be directed against any country and need not lead to an attitude of fear by any country, but it could indeed result in improved international relations and in solving some of the problems of our unsettled world.

Europe could achieve this if she would strive for a civilized industrial society in our times and not worry about society and technology in any hypothetical future post-industrial civilization. The miracles of technology can take us to the moon but then we must come back to our world which is torn by social injustice and divided into developed and underdeveloped countries; we must come back to our American or European towns, where our eyes can behold large white and black ghettos, where our ears can be offended by the din of traffic or other similar concerts, where we can breathe air polluted in different flavors, and touch with hands the concrete consequences of an industrial society going out of control.