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FOREIGN INVESTMENT IN POST-WAR PERIOD

ADDRESS

of

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Anything involving foreign investments -- particularly the sale of foreign securities in this country -- is of more than casual interest to all of us as securities commissioners. Between 1920 and 1931 some 9.3 billion dollars of foreign bonds, both governmental and private, were sold in this country. With the bonds of some foreign governments yielding, or promising to yield, as much as eight percent, American investors gobbled up whatever was offered. Investment bankers vied with one another for the privilege of thrusting American dollars upon prospective foreign borrowers.

There is not time here to attempt to analyze the overall economic consequences of the lending that was done in that period. Indeed, in view of the hypothetical estimates that would be involved, it might be extremely difficult to arrive at even an approximately correct analysis. The record is plain however as to the effect upon individual investors of some of the indiscriminate lending done during that period. Its almost inevitable consequence was that many of those who then invested their money abroad took a licking.

It has been estimated that, by 1935, some 37 percent of the foreign bonds outstanding in this country were in default and that by 1937 six or seven hundred thousand American investors were holding defaulted foreign bonds.

For their role in this debacle, investment bankers have been subjected to widespread and vigorous criticism. Of the various criticisms, the most significant from our viewpoint is the claim that huge amounts of the funds sent aboad were incompetently invested -- that they were placed in enterprises which even a superficial inquiry by those handling their placement would have disclosed had little or no chance of ever repaying them.

Had there been full disclosure many of these bond issues would never have been sold. Had there been full disclosure with respect to the asset values of issuing companies, with respect to their capital structures, their history of profits and losses, and the interest of promoters; had there been, in the case of foreign government bonds, full disclosure as to debt structures and revenues and the history of past defaults, we may be sure that American investors, who as a whole, are not so gullible as is sometimes supposed, would have been more discriminating in the purchases they did make, and that many of the losses that occurred would have been avoided. It is likely to be our responsibility to see to it that the excesses of the twenties are not repeated and that whatever new foreign issues may be sold are sold in accordance with standards of ordinary honesty and decency.

At the same time it is essential that we realize, and American investors must come to understand, that a full and truthful disclosure alone is no assurance that any particular investment will be profitable. There are many elements of risk in investment that cannot be eliminated even by the most scrupulous fair dealing. This is particularly true in the case of foreign investment, where in addition to the ordinary risks that attend investment in domestic enterprises there are special hazards, different in kind and different in degree. Foreign investments cannot be profitable for example if world trade is choked by artificial tariff barriers; the principal may be wholly lost if there is outright repudiation. If there is war no one can foretell what may happen -- many factors not directly significant in appraising domestic investment opportunities may enter the picture and cause losses.

Difficulties such as these do not merely melt away in the warmth of an abstract feeling of international good will. Experience has shown plainly enough that foreign investment is not a magic lamp that automatically invokes benign genii to insure safe profits to the investor and good works with the money laid out. Wisely directed, foreign investment can bring fair returns to the investor and great benefits to the people of his country and to those of the country in whose enterpise he invests. But foreign investment is a delicately complicated instrument. It has profound potentialities for good and for evil. It cannot safely be handled carelessly, either as a general economic program or as an individual enterprise. It is subject to many collateral influences beyond the direct control of the parties to the lending contract. For relative safety to the investor and full economic effectiveness, foreign investments require a base of political and economic stability and a reasonable opportunity for reciprocal interplay of those productive forces through which their usefulness may be realized. If foreign investment is to provide reasonably safe opportunities to put savings to remunerative, constructive use, and is to play its proper part in the reconstruction and in the maintenance of a peaceful security of opportunity here and abroad, the nations of the world, for their mutual advantage must join in adopting and making effective wise economic policies that will forestall the disruptive forces which in the past have blocked these beneficial consequences. Enlightened public opinion must understand and support such policies.

As security commissioners we are looked to in matters of investment primarily for protection against undue risks of loss. If we are not to be unduly parochial in our concept of the job we have to do, it is essential that we ourselves understand the basic problems of foreign investment and that we help to foster a *general* understanding of them. A responsibility equally great, if not greater, rests upon the investment banking industry.

Because these things seem to me to be extremely important in connection with the more immediate problems likely to confront us as securities commissioners, I want to touch briefly upon some of the questions that bear upon any program of private foreign investment that may develop. In view of the experience of the past, should we get into foreign investments at all? Is it necessary? Is it desirable? Is it wise or foolish? What forms will it take? What conditions are necessary in order that it may be reasonably safe and effective as an aid in meeting the economic problems that will confront us after the war?

Our most immediate domestic objective after the war will be the maintenance of full, steady employment for our labor force of 60 million. The President has set that goal. What bearing may foreign investment have upon its achievement?

According to an estimate in the Federal Reserve Bulletin of May, 1944, the resumption of peace-time production at the 1939 level — a gross national production of 108 billion dollars at 1943 prices — would leave us with from fifteen to twenty million unemployed. According to that same study, if full employment is to be reached, the national production will have to exceed 170 billion dollars. That's a lot of goods.

At that level of production it has been estimated that annual savings would be somewhere between 25 and 30 billion dollars a year and that if the total amount of those savings were regularly reinvested, we could maintain full employment. If not, the phenomenon variously called overproduction or underconsumption would be likely to develop. We would come to have surplus goods on the market that could not be absorbed by the consuming public for lack of sufficient purchasing power. In those circumstances our industries would have no economic incentives to absorb them for use in the production of other goods. Such surpluses, unused, would give rise in turn to curtailment of production, to unemployment, to further lowered purchasing power and progressively decreasing incentives to make capital investment.

There are doubtless many who believe it is possible to achieve full employment on the domestic level without foreign trade except for the minimum amount necessary to maintain a flow of indispensable imports. The experience of the past, however, suggests the contrary and I believe it is generally recognized that the expansion of our foreign trade, coupled with new investment abroad, wisely placed and carefully administered, can play a highly important role in any program designed to maintain full employment in this country. Foreign investments competently placed can provide immediately broadened markets for our products and, through their contribution to the development of the countries in which the investments are made, can increase the purchasing power of those countries and further enhance their demand for goods produced elsewhere including those produced in the United States. These are by no means inevitable consequences of any foreign investment, but they are probable consequences of a wisely and carefully administered program, carried out under conditions that will permit the trade engendered to flow free of unduly arbitrary blocks and hindrances.

Foreign investments may take various forms. They may for example take the form of extension of credit by the Government itself, as we have done through the Export-Import Bank. The recent statement of Mr. Dean Acheson, Assistant Secretary of State, before a subcommittee of the Special House Committee on Postwar Economic Policy and Planning, suggests a greater role for the Export-Import Bank than it has had in the past.

We are not concerned here, however, primarily, with Government loans, but rather with private ventures into foreign enterprise. These may take either of two general forms: First, the purchase of foreign securities by American investors.* Second, direct investment by American industrial enterprises, with the resulting establishment of foreign branches and foreign subsidiaries.

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* Repeal of the Johnson Act, as urged by Mr. Acheson, would remove one obstacle to this type of investment activity.

Apparently there are ample savings available for substantial investment of both kinds. According to computations of the Securities and Exchange Commission, as of June 30, 1944, individuals in the United States held 84 billion dollars in currency and bank deposits, plus 46 billion dollars in United States Government securities, a total of 130 billion dollars. Before we entered the war these figures stood at 51 billion dollars and 14 billion dollars respectively. In other words, there has been an increase of about 100 percent in these highly liquid types of individual saving.

As for corporations, on June 30, 1944, their net working capital reached an all-time high of 44.3 billion dollars, as compared with 32.1 billion in 1941. So there is likely to be an adequate supply of capital available for foreign investment if suitable opportunities arise.

The incentives to foreign investment are another story. It is at least conjectural whether there could be any immediate substantial investment abroad without some measure of governmental or quasi-governmental guarantee for the safety of such investments.

The International Bank for Reconstruction and Development, whose structure and proposed operation were outlined at the Bretton Woods Conference, is designed to provide such a guarantee. The Bank would start out with an authorized capital of 9.1 billion dollars, to which the various member nations would contribute proportionately. The share of the United States would be a little over 3 billion dollars.

The Bank would be authorized to participate in and guarantee loans to foreign governments and foreign enterprises in an amount equal to 100 percent of its capital reserves and surplus. Direct loans may be made with 20 percent of its subscribed capital and with funds borrowed in the world's money markets.

The other 80 percent of the subscribed capital, reserves and surplus has been reserved to guarantee loans made through private investment channels and to meet direct obligations of the Bank. The various members would be jointly and severally liable with the Bank up to the amount of their subscriptions. However, calls to meet obligations through the Bank's guarantee operations will be uniform on all shares. In addition, where the Bank makes or guarantees a loan to a private borrower in any country, the Government of that country or its central bank would be obliged to guarantee the loan.

The Bank would finance or aid in financing a project only if satisfied that the borrower, without its help, would not be able to get the loan on reasonable terms elsewhere, and only after investigation of the merits of the proposal and a favorable report by a special committee appointed for that purpose. The fact that the Bank would make charges for its guarantees would serve as an incentive to purely private unguaranteed lending.

If the Bretton Woods proposal for the International Bank should be adopted by the various conferees, (and I believe it has not yet been submitted for approval by our own Congress), it seems highly likely that foreign investment from this country would be markedly stimulated, at least to the extent that the Bank may be willing to guarantee such investments.

The extent of private foreign investment wholly independent of the activities of the Bank will depend, of course, on the possibility of safe returns in the absence of any guarantees. Prospects of a safe return will depend, in turn, upon the degree of economic recovery abroad, upon the stability and the policies of foreign governments, and on the degree to which sound and stable trade relations are achieved among nations. On these factors likewise will depend the extent and the success of direct investments that may be made abroad by American corporations. Indeed, the effectiveness and future success of the Bretton Woods Bank itself must depend upon world-wide economic recovery and stable trade relations, for if borrowers cannot make repayment, any initial flood of loans would narrow to a trickle and finally dry up completely.

At the core of these possibilities is international trade. If we expect nations to buy from us, we must be willing to buy from them, unless indeed we are willing to add more gold to our 21 billion dollar hoard. And even if we were to do that, the fact is that the amount of gold in other countries is relatively limited and we couldn't go on long on that basis. If other nations are not only to buy from us but also to service our investments they must acquire somehow the ways and means for doing so.

Theoretically, we can provide them with such ways and means by either of two methods. One would be to maintain an excess of imports over exports, what has been referred to traditionally as "an unfavorable balance of trade." This would provide foreign nations with a ready source of dollars to meet interest and amortization charges on their debt to American investors and to buy American goods. This has been the traditional British method, and apparently the British experience with foreign investments has been far happier than our own. If such a balance were to be established suddenly, there would of course be grave dislocations in our domestic economy. It may be, however, that in time, especially if some of our natural resources become seriously depleted (and this is a prospect that cannot be wholly ignored in view of the hastening of that process by the inroads of the war), we may be in a position where it would be definitely advantageous to accept an excess of imports. At least we must face candidly the question whether that might not be a good thing for our economy and be prepared to answer that question, not by some momentarily expedient rationalization, but by a realistic appraisal of our own best interests for the long pull.

On the other hand, there is the possibility that the development of synthetics, such as artificial rubber and many other similar synthetic products, may prevent our ever having an excess of imports over exports.

Another method whereby, theoretically, we might provide foreign debtors with the wherewithal to service our investments would be to maintain a continuing flow of investments abroad. In that way, too, dollar balances, over and above the amounts needed to pay for our exports, would be made available. But it seems plain that continuous investment alone, without an increase in imports, could not afford a permanent solution. Because of the ever-growing servicing charges, the amounts necessary to keep the ball rolling would become increasingly larger and in time a crash, like the one of the early thirties, would be inevitable. At that point private capital would drop out of the picture, leaving the Government to continue the process, if it were inclined to do so.

It seems equally plain that continuous foreign investment, whether conducted through private or governmental channels, in the absence of a corresponding increase in dollar volume of our imports, would come to amount in substance to a subsidy to foreign nations. We would be paying them for the favor of buying our goods. It is true that for a time at least jobs might be created that way. But we should consider whether there aren't other and superior ways of creating jobs. We might be far better off in the long run, for example, if instead of a continuous foreign subsidy we were to devote our resources and our energies to the contruction of schools and hospitals and playgrounds and to conservation projects -- as we did in the great public works programs of the thirties

The logic of the situation suggests that if we are to have a successful foreign investment program over the long pull sooner or later we must increase our imports, and, until such time at least as our imports exceed our exports, our foreign investment program must be a continuous one. This is not necessarily a grim prospect. On the contrary, the achievement of genuinely reciprocal foreign trade is rich in promise of sound benefit to our own economy.

The achievement of such trade relations, however, will depend unavoidably upon a mutual reduction of international trade barriers. The trade barriers of other nations must be lowered as well as of our own. Removal only of the barriers we ourselves have erected, if others do not reciprocate in due course, would doubtless cause severe dislocations in our domestic economy. Moreover reduction of only our own barriers could not be effective, by itself, to bring about that favorable condition of trade and prosperity among nations which alone can ensure the success of a foreign investment program. It seems probable that the removal of barriers to international trade could be accomplished most effectively through multilateral agreements, or short of that through an intensification and extension of our Reciprocal Trade Agreement program. Such dislocations as might be caused in our domestic economy would thus be largely compensated by the opening of new markets for our goods.

In shifting to a basis of freer international trade it would be necessary to give some thought also to measures that might need to be taken at home to make the adjustment easier during the period of transition -- measures such as financial aid to help farmers in switching to new crops and to aid displaced industrial workers in retraining for new tasks, measures to facilitate the transfer of capital investment from one industry to another.

Of course one way that might be suggested for increasing imports without immediate substantial tariff concessions would be to maintain a high level of productive domestic industrial activity, which in turn would create a natural demand for foreign goods, particularly raw materials. If that could be accomplished a healthy employment situation in this country would make it easier to reduce existing trade barriers because the dislocations that such adjustments might cause could more easily be absorbed. But there might be serious hazards in depending solely upon the maintenance of an independently prosperous home economy to solve our international problems for us. The achievement of such a level of activity wholly independently even for relatively short periods presents tremendous problems. It would seem safer and more far-sighted to assume that the problem of maintaining full employment after the war will require all possible measures to increase the scope of our foreign as well as our domestic commerce. The reduction of trade barriers is one of the immediate essentials if that course is to be followed. We have the opportunity to assume the initiative. The influence and the strategic position of the United States should count heavily in making such a program a success.

Let's look briefly at some of the consequences that might be expected from increased freedom of international commerce and some of the basic conditions essential to the achievement of those consequences.

The progressive elimination of obstacles to international trade would be likely to promote the development of areas now not highly industrialized. It could create new and greater purchasing power among millions of persons. It would permit the production of goods in those places where they can be produced most economically, with resultant economy in effort, and a higher standard of living for peoples of the world, ourselves included. It should result in more stable and amicable relations among the nations of the world and lessen the bases of future conflict.

Obviously such a world would have to be one where relations had been established on a basis of mutual understanding and respect. There could be no room for old fashioned dollar diplomacy. Extraterritoriality would be dead. All nations would have to be Good Neighbors. The continued safety of foreign investments, and profits from them, would depend, not upon imperialist exploitation, but upon international good will, mutual recognition of the sovereign rights of all peoples, and the free interplay of industry and commerce based upon mutual advantage. Such a world could provide unparalleled opportunities for the American investor and the investment banking industry for a long, long time.

Obviously this sounds like a brave and brightly burnished new world. It is the kind of world that's been promised thousands of times by those who have favored freedom in international trade. As far as I know it has never been tried, at least in modern times. There would be little sense in belittling the difficulties that are likely to beset any program for its achievement. The real difficulties are tremendous. They rest largely in human qualities that have persisted with little perceptible change from ancient times into the middle of this twentieth century. The arguments of expediency likely to be raised against almost every step towards its achievement are innumerable and in the main highly plausible. Doubtless in due course you will hear them all.

But I wonder whether it isn't about time — in the midst of this ghastly blowup that has followed centuries in which the nations of the world have haphazardly pursued various economic expedients and stopgaps — to stop and think what the alternatives are — to consider — getting back to foreign investments — whether there is any other kind of a world in which foreign trade and foreign investments can be expected to prosper over any extended period of time. We are approaching a crucial time for decision of issues that bear on these problems. I hope that we shall have the foresight, the judgment, the courage, and sufficient historical perspective to make the right decisions.

Mr. Herbert Feis, formerly Economic Advisor to the State Department, has said in his recent book, The Sinews of Peace:

> "The people will understand, if political leadership does not bewilder them, that international order and peace cannot be bought by any country entirely at its own convenience and on its own terms. They will also know that although it will be wise and necessary to maintain military establishments of sufficient strength to protect vital interests and security, peace and commerce cannot indefinitely rest on force alone. They will accept the economic adjustments that may be clearly essential to create a firmly intimate basis for international relationship as they accepted the grim sacrifices of war."

As securities commissioners you and I cannot change the world or greatly influence its change. That is not our job. But we are very likely to have a lot of proposals for foreign investment in our laps one of these days and we are going to have to know a lot about what chances they have of being successful investments. It is essential that we give thought to the general economic background against which we shall have to make our particularized decisions. It seems to me essential, also, that we aid those who look to us for protection in matters relating to securities and investments to understand those currents of present thought which, depending upon whether or not they are diverted, give some promise of leading towards cooperation and rational commercial intercourse among nations. Truth in securities, the regulation of exchanges, supervision of certain activities of investment bankers and brokers — these are immediate tasks and important tasks — but they fall far short of assuring profitable foreign investment. There is a fundamental truth, not covered by our statutes, that if foreign investment is to be secure, nations must contrive in some way to live together peaceably and prosper together.