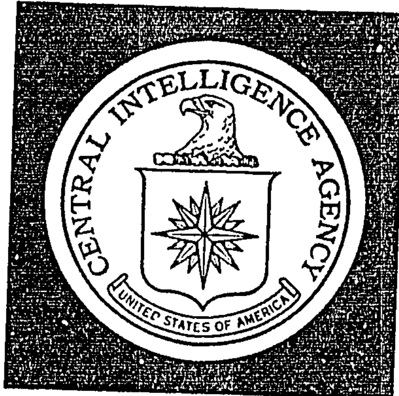
25X1
Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7
Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7 CIA/OER/IM 68 FILES

25X1

Confidential



DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Belgium's Aggressive Bid for Foreign Capital

Confidential

Copy No. 43

ER IM 68-8
January 1968

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1
EXCLUDED FROM AUTOMATIC
DOWNGRADING AND
DECLASSIFICATION

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7
CONFIDENTIAL

25X1

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
19 January 1968

INTELLIGENCE MEMORANDUM

Belgium's Aggressive Bid for Foreign Capital

Summary

Prior to the announcement of the US balance of payments restrictions, the resolution of a controversy between Belgium and the governing Commission of the European Communities (EC)* over appropriate incentives for foreign investors promised to have far-reaching effects on the flow of American capital to the Community countries. In July 1966, Belgium passed an extremely liberal investment incentives law in the hope of attracting larger amounts of foreign capital, particularly from the United States, to stimulate its sluggish economy. The Commission challenged the law on the grounds that a disproportionate flow of foreign capital to Belgian industry would give Belgium an unfair advantage in intra-Community trade, and implementation of the law was delayed until 1967. The fundamental questions raised by the controversy concern: (1) how receptive a policy toward US investment the EC ultimately will adopt, and (2) how influential the Commission will be in opposing national development programs which diverge from that policy. On the first question, neither the Commission nor the six member

---

Note: This memorandum was produced by CIA. It was prepared by the Office of Economic Research and has been coordinated with the Office of Current Intelligence.

** In July 1967 the executives of the European Economic Community (EEC), the European Coal and Steel Community (ECSC), and EURATOM were merged into a single Commission of the European Communities. The new Commission will continue to administer the terms of the three separate Community treaties until these themselves are merged.*

CONFIDENTIAL
Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

25X1

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

nations have been able to define a common policy. Because of this indecision and Belgium's perseverance in the face of the Commission's objections, the second question has been settled in Belgium's favor, at least temporarily.

The recently announced US balance of payments restrictions are likely to adversely affect Belgian economic growth and development. If the Belgians, who are basically sympathetic to the objectives and techniques of the payments program, judge that it will be relatively short-term in nature, they will probably continue to rely on US capital flows in their development planning, choosing to accept the heavy short-run losses resulting from the US program. On the other hand, if they judge that the program will persist for a longer period, they will almost certainly reorient their development planning away from reliance on transatlantic capital flows. If this occurs, American investors will have lost their foremost advocate in the EEC.

A small, industrialized country situated on the ancient crossroads of Europe, Belgium has found rapid economic progress in the EEC an elusive goal. Since the creation of the Common Market in 1958, the Belgian rate of economic growth has been the slowest in the EEC, despite a spurt in 1960-64 aided by an expansion of exports to Belgium's Common Market trading partners. Since 1964, growth has slowed down markedly. Belgium's continental neighbors have moved more aggressively to diversify their industries, modernize economic institutions, and improve their capital markets. The present Belgian Government is now using extremely generous inducements to foreign capital as a key element in development policy, designed to speed up the growth of modern, efficient industries and permit the diversion of manpower and government resources away from those which are high cost and, like coal mining, require subsidy.

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Background

1. The Belgian Government in 1966-67 embarked on a new policy of seeking foreign investment funds to stimulate domestic economic expansion. Recently passed, extremely liberal investment legislation, providing for direct government grants and subsidies to investors, has made Belgium an especially attractive location for foreign capital. Most industry investment attracted to Belgium has been coming from the United States; the American share in recent years has been running between 50 and 90 percent.

2. Recognizing the important implications of the new Belgian policy, the governing Commission of the European Communities acted on a complaint by the Netherlands to test its control over members' national legislation, thus delaying approval of the Belgian statutes and challenging some of their provisions. Articles 92 and 93 of the Treaty of Rome, which established the EEC, require that the Commission continuously examine national policies for evidence of distortion of intra-Community trade and decide whether such distortion, if found, is permissible under the discretionary clauses of Article 92. Article 93 gives the Commission power to review any new or modified system of investment incentives before it can be put into effect. The Treaty bans national practices which distort competition within the Common Market.

3. The Commission has had difficulty in defining an EEC "common interest" in foreign investment because the members themselves do not have a consistent attitude toward foreign investment. At present no EEC member, except France, shows open hostility to investors from outside the Community, even from across the Atlantic. Nevertheless, there is considerable divergence in national policy approaches. Because of such diversity, the Commission probably would have refrained from intervention if the new Belgian policy had not presented such an exceptionally attractive welcome to foreign investors.

4. A basic issue has now developed between the Belgians' view of what is needed to secure the benefits of modern technology for their economy and the Commission's view, still unclear, of the EEC's

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

"common interest." Even more fundamental are the questions now being raised of a common policy for the EEC toward US investment and the role of the Commission in carrying out that policy, even at the expense of the development program of a member nation. These basic issues will receive increased discussion throughout the EEC, as the US balance of payments program of 1968 takes effect.

Foreign Investment Policies of EEC Members

5. Differing attitudes in the EEC toward US capital are indicated in the table below. From 1963

Table

Net US Direct Capital Investment in EEC Countries a/
1963-66

Country	Million US $				Percentage Share of EEC Total			
	1963	1964	1965	1966 b/	1963	1964	1965	1966 b/
EEC total	*588*	*807*	*857*	*1,140*	*100*	*100*	*100*	*100*
Belgium-Luxembourg	35	75	117	122	6	9	14	11
France	164	139	152	93	28	17	18	8
West Germany	216	276	359	614	37	34	42	54
Italy	120	207	158	150	20	26	18	13
Netherlands	53	110	71	161	9	14	8	14

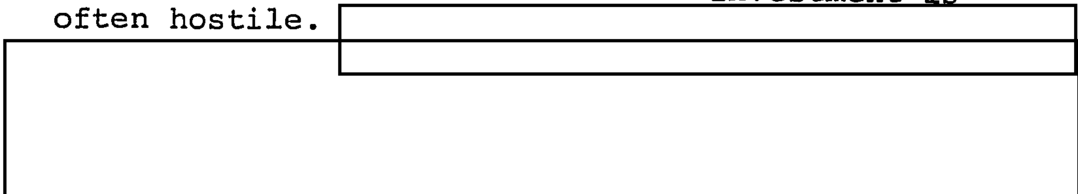
a. Data show net direct capital investment flows (balance of payments basis) from the US to EEC countries in each year, not cumulative US investment. Reinvested earnings of US firms and portfolio investments of US nationals in EEC countries are not included. Source: US Department of Commerce, Survey of Current Business.
b. Preliminary data.

through 1966, Belgium-Luxembourg and the Netherlands substantially increased their shares in US direct investment going to the EEC, although West Germany remained the principal recipient. At the same time the French share of total US investment in the EEC declined in both absolute and relative terms. US firms establishing production facilities in the Common Market area are increasingly favoring countries that have positive investment incentives,

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

such as Belgium, or that have strong internal markets, such as West Germany. These firms are becoming less attracted to France, where the official attitude toward American investment is often hostile.

25X1



25X6

6. The Belgian share of total US capital in the EEC has grown rapidly since 1962, but it is still small relative to the share of West Germany. Passage of an earlier investment incentive law in 1959 helped to stimulate growth in the Belgian economy. In 1964, facing inflationary pressures and a tightening labor market, the government restricted its investment incentive programs by placing priorities on specific regions and on those projects promising to introduce new technological processes. During 1965 the economy was generally sluggish, although foreign investment continued to be a principal expansionary force. The government feared a tapering off of foreign investment in 1966, as the economy continued to slow down.

7. Past inflows of capital to Belgium have settled mainly in the economic triangle formed by Antwerp, Ghent, and Brussels. The investment incentives under consideration in 1966, on the other hand, were aimed primarily at the areas where investment rates were low (Liege, Mons, Charleroi, and other areas of Wallonia) and labor was more available. The Government wanted to grant priority to Wallonia and to research projects which would directly improve Belgian technology. However, political pressures and economic needs ruled out a selective investment policy, and the government passed the more liberal, nonselective Investment Incentives Law of 1966.

8. Because the new law did not become effective until February 1967, some investors postponed new outlays which otherwise would have been made in 1966. This is reflected in preliminary 1966 data in the table, which show that Belgium's share of the capital flow declined from 14 to 11 percent. Foreign investors generally, and particularly those in the United States, have reacted very favorably

to the new Belgian investment policy, and the flow of investment funds to Belgium is expected to increase substantially.

9. The Netherlands also depends heavily on foreign capital investment and sees the new Belgian investment law as a threat to its competitive position. The Dutch, however, have not been willing to back their general friendliness to foreign investors with comprehensive investment guarantees, tax relief, or cash incentives to match the Belgian competition. In 1966, they chose rather to ask the Commission, as interpreter of Articles 92 and 93 of the Treaty of Rome, to look into the possibility that Belgian law discriminates in favor of foreign investors far more than do the investment incentives of any other EEC member. The inconclusiveness of the ensuing controversy between Belgium and the Commission -- resulting in at least a temporary victory for the Belgians -- may induce the Netherlands to seek foreign investment funds more aggressively in the future. In that event, the challenge to the Belgian laws within the EEC could disappear.

10. West Germany, with the largest and strongest economy in the EEC, has enough other advantages to attract large amounts of foreign capital without giving special investment incentives on the federal government level. The nationalistic argument against foreign control of German industry that arises from time to time in West Germany has been overcome by a pragmatic business community which recognizes the importance of foreign capital to the growth and prosperity of the German economy. For the foreign investor, the investor incentives, propagated mostly by the laender (states) and municipalities, are heavily reinforced by the existence in Germany of the EEC's largest market, a trained and disciplined labor force, and an efficient distribution system.

11. Italy has a favorable attitude toward US and other foreign investors. US investors control no major sector of Italian industry, and a large portion of Italian industry is itself controlled by powerful governmental and quasi-governmental holding companies (for example, ENI and IRI). The south of Italy is the most economically backward area in the EEC, and US investors are warmly received there with tax

relief and incentives in the form of loan capital on very favorable terms. By and large, however, US firms have preferred to invest in the industrial north, where skilled labor, transportation, and power are more readily available. Because investment incentives are limited to the underdeveloped area -- a limitation consistent with the Treaty of Rome -- the Italian investment law has not been questioned by the Commission.

12. The French Government has repeatedly voiced fears of American control of important sectors of French industry, especially electronics and food processing. A basic policy change became apparent when Giscard d'Estaing was replaced by Michel Debre as Finance Minister in 1965. Since then, France has at least been willing to allow US investors to enter, subject to the registration and administrative scrutiny of all new investment projects. Although few new projects have been disallowed since 1965, France has been much more explicit than any other EEC country in making plain to foreign investors that it wishes to retain its options for control. Investment in France by US firms fell sharply in 1966, largely because of the generally cool attitude of President De Gaulle toward the United States and US investment. A restrictive policy on the part of France diverts foreign investment to other EEC countries -- notably West Germany and Belgium. From those countries the products of foreign-owned firms can enter the French market unhindered via the EEC, while the French economy receives none of the benefits of increased employment and greater productive capacity.

The Belgian Economy and Its Special Problems

13. Because Belgium is limited in size and natural resources, it depends heavily upon foreign commerce to provide raw materials for its industry and markets for its products. Total trade turnover (exports plus imports) annually equals three-fourths of the Belgian GNP, which reached US $18.1 billion in 1966. About 70 percent of Belgium's industrial output is exported. This outward orientation of the economy -- traditional since medieval times -- has made Belgium a strong and consistent supporter of free trade and payments. Belgium has always promoted European movements for integration. This small country, however, whose capital has become

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

the center of a great experiment in economic union, is the Common Market's principal underachiever. The nation's average annual rate of economic growth in real terms during 1958-66 was only 3.9 percent -- not only the EEC's lowest but also little better than the average annual rate of 3.4 percent posted in the pre-EEC period, 1951-57.

14. Belgium's disappointing economic performance has many roots. Although industrial output accounts for about one-third of GNP annually, it is concentrated in heavy industries such as steel and basic chemicals, which currently suffer from excess capacity and slack demand throughout Europe. The steel industry, especially, has been a marginal producer, and neither EEC membership nor the even longer relationship with the ECSC has produced a hoped-for structural change. Production in the coal industry has been declining and further cuts are forecast, at least through 1970, since the prospects for viability are dim. Throughout the economy, low productivity and low profit margins have inhibited adequate development of domestic capital markets and diversification of domestic industry.

15. Within Belgium, there are divergent rates and levels of economic development between French Wallonia and Flemish Flanders. Flanders, in the north, is Belgium's developing industrial region. With an average annual real growth of 4.2 percent during 1955-64, this flourishing area accounts for two-thirds of all foreign investment in Belgium. Wallonia, in the south, is the center of the traditional industries and antiquated coal mines. During 1955-64 it managed to achieve a real growth of only 2.6 percent in GNP and to attract only one-third of the total foreign investment.

16. Because of the diverging growth patterns between Wallonia and Flanders, the central government has assumed an increased role in national economic affairs. Although favoring balanced budgets, the authorities have run deficits in order to finance higher levels of spending for both public welfare and investment projects. Many of these ventures have been financed by borrowing in the narrow domestic capital market, thus reducing

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

funds available for private investment. At the same time, the demands of public finance have forced the monetary authorities into an excessive expansion of the money supply. To avoid inflation, the government has periodically resorted to tight money and deflationary measures.

New Policy Response

17. Having failed to achieve satisfactory economic growth, Belgium has turned abroad to find investors who will bring the advanced technology, managerial skills, and capital needed to forge a strong competitive position in the EEC and world markets. The government anticipates that foreign investment will effect structural changes in Belgian industry to accommodate changing patterns of world demand, will stimulate domestic investment, and will increase economic activity in depressed areas. In part, the government's policy is based on concern that the deepening economic depression in French-speaking Wallonia will strengthen separatist movements. The government believes that several large foreign plants in Wallonia could do more to promote rapid development and continued political unity than a public program to modernize the infrastructure.

18. Belgium's commitment to free enterprise, its stable political and economic institutions, its excellent port facilities on the North Sea, and its position as the capital of the Common Market, combine to give the country an appeal to foreign investors. An additional attraction is the new Investment Incentives Law of 14 July 1966, which contains extremely liberal provisions for both foreign and domestic investors, including cheap credit, capital grants, and tax concessions. Its chief provisions are:

a. Interest subsidies of 5-percent maximum for a 5-year period, with coverage of total interest charges for the first two years in special cases.

b. Government guaranties for repayment of up to 75 percent of a loan from private sources.

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

c. Reduced tax rates on capital gains reinvested in specified regions.

d. A double depreciation rate for three years.

e. Exemption from taxes on real estate and improvements for up to 10 years.

f. Nonrepayable capital subsidies from the government to cover part of new investment in buildings and equipment.

19. Even before the basic investment incentives became effective in February 1967, new legislation was deemed necessary to spur economic revival, accelerate regional development, and stabilize the budget. Thus in January 1967 the government was given special emergency powers to accomplish these ends. The initial task was to employ more efficiently the existing incentives program. A new ministerial committee was created to coordinate the activity of all ministries in the field of investment and to consider all applications for incentive benefits. The committee organized a Permanent Office for Locating Foreign Investors to spearhead the search for potential investors in the United States, follow up government missions seeking investment, and organize private missions. In order to channel investment into areas of greatest need, the government decreed that only investments identified as being in the national interest and located in priority regions could benefit from interest subsidies greater than 4 percent, interest subsidies for longer than three years, exemption of the company withholding tax for more than five years, and fast depreciation for tax purposes. However, some new incentives were added -- rules on company mergers were eased, revenue earned from new investment capital was exempted from corporate income taxes for the first five fiscal periods, and opportunities were provided for companies created between 1 January 1967 and 31 December 1969 to write off, over an unlimited period of time, the losses sustained in their first five fiscal periods. In addition, an expansion fund to finance investment incentives was set up.

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

Conflict from an Unexpected Quarter -- the EEC

20. Belgium, one of the EEC's strongest proponents, has come under fire from the Commission for being too outward looking and too generous in its economic incentives for both domestic investors and foreigners. Throughout the latter half of 1966 the Commission delayed approval of the Belgian Investment Incentives Law, claiming that the law, although principally addressed to the redevelopment of coal mining areas in Belgium, was not confined to such areas. The Commission emphasized the importance of concentrating assistance in the coal mining areas of Wallonia and Limburg rather than in the whole economy, as planned by the Belgian Government. The Commission claimed that because of Belgium's small size, too wide an application of the law would cause unnecessary discrimination between regions and give blanket help to new industries throughout the country. The Commission said that the law would violate Article 93, dealing with government subsidies.

21. Commission approval of the new Belgian law was finally granted in January 1967. However, the Commission felt that special tax concessions offered by member governments could distort competition in the Common Market, and it required Belgium to report to the Commission every six months all capital subsidies of 25 million Belgian francs and above and all investments of more than 150 million francs involving interest subsidies.

22. With this compromise decision, the Commission hoped to avoid a situation similar to one in 1964 when the Belgian Government provided a very generous preferential loan to the Ford Motor Company to induce Ford to convert an Antwerp auto plant into a tractor plant. Antwerp was not a depressed area, and other EEC tractor manufacturers were not doing well at that time. Reviewing these facts, the Commission ordered the Belgian Government to withdraw its aid even though Ford had begun the conversion, based on the Belgian commitment. Belgium's settlement with Ford in this case was never made public, but it is likely that the Commission finally approved some of the aid to Ford.

23. Although the new Belgian law has been more or less approved by the Commission, the underlying issue that is still unresolved concerns the criteria that the Commission will use in reviewing government aid and subsidies granted by member states. Articles 92 and 93 of the Treaty permit distortion of intermember trade only within depressed areas, or in projects of common European interest, or where the aid does not affect trading conditions to a degree that would be contrary to the common EEC interest. The problem consists of defining a "common interest" consistent with each member's notion of its own development needs. It continues to be one of the great unsettled questions of European economic union.

Impact of the US Balance of Payments Program on Belgian Policy

24. Because Belgium has keyed much of its development policy to anticipated flows of investment funds from the United States, the recently announced balance of payments program will have considerable impact on Belgian economic planning and development. If all new US investment ceases, Belgian economic growth in 1968 probably will be slower than anticipated before the announcement of the US restrictions. If the restrictions remain in effect for several years, major development goals such as the diversification of industry, improvement of technology and development of backward regions will be seriously affected. According to one estimate, 75 percent of the firms moving into the eastern part of the country are American-owned, and 20 percent of the new capital scheduled to be invested in the area was to have come from the United States. Some of the effects of the cessation of US investment may be offset by means of expansionary fiscal and monetary measures, including government-sponsored development projects financed domestically. But as Belgium's recent history has shown, the effectiveness of such policies is limited. Due to institutional rigidities and the poor development of Belgian capital markets, such policies in the past have usually resulted in inflation without real growth rather than real growth without inflation.

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7

25. Given Belgium's long history of economic cooperation with the United States, it is likely that the Belgians will be sympathetic to the US balance of payments program, notwithstanding its impact upon their own country. The Belgians probably will continue to be receptive to US investments, but they may be forced to reconsider the role of US investments in national development policy. The Belgian government's decision in this regard will depend, in large part, on estimates of the probable duration of curbs on US overseas investment. If the government judges that the program is essentially short-term in nature (that it will last only about a year), then it may decide to absorb the losses of foregone investment, relying on the prospect of larger capital inflows in the future. On the other hand, if a judgment is made that Belgium cannot count on US capital for some years to come, a major reorientation of Belgian development policy away from reliance on the United States is likely to be made.

26. In the latter case, American investors will have lost their foremost advocate in the EEC. Belgium's hitherto friendly policy towards US investment no longer will be available as a counterweight to less liberal policies -- such as the French policy -- that prevail within the Community.

Approved For Release 2005/01/11 : CIA-RDP85T00875R001500220010-7