Volkswagen's Investment in the United States: A Pacesetter for Foreign Investment?

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In April 1978, Volkswagenwerk AG began manufacturing operations in Westmoreland, Pennsylvania. The Pennsylvania plant is the largest foreign automobile factory in the United States and was one of the largest direct foreign investments ($300 million) ever to be made in this country. David Aviel examines the factors leading to the investment, concentrating on the decisionmaking process within Volkswagen and its negotiations with the host state. The Volkswagen investment is discussed with an eye toward the implications for other large foreign investments in the U.S. and the ways in which Volkswagen may be setting the pace for foreign investors.

Background

Early in 1937, a young German engineer named Ferdinand Porsche completed his design for a simple, inexpensive and reliable automobile. It was an odd design that ran contrary to accepted automotive engineering wisdom. The engine was air-cooled, had a flat design with four cylinders at 180° angles, and was placed behind the rear axle. Transmission and differential were combined in one unit. There was no driveshaft. Suspension was independent with torsion bars in the front and swing axles in the rear.

The National Socialist government in Germany adopted the model and named it "Volkswagen" (the people's car), with the aim of making the car available to everyone through a loan program for all working men. A large factory was built near the hamlet of Wolfsburg in the economically depressed state of Lower Saxony. By the time the plant was ready to start production, however, World War II had broken out and the objectives of the government had

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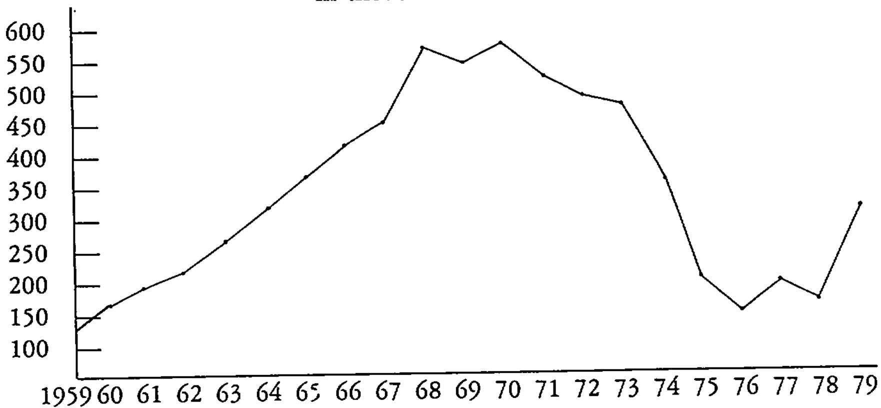
changed. Apart from a few hundred Volkswagens that found their way into the hands of selected party veterans, the entire capacity of the plant was geared toward supplying the German army with military vehicles. Thus Volkswagen (VW) was partially a political creation from its inception.

At the end of World War II, Wolfsburg became part of the British occupation zone. In 1948, the British turned the factory over to the government of the Federal Republic of Germany. The government appointed Heinrich Nordhoff, a member of Porsche's old team, to chair the executive board. Nordhoff found the 1937 design eminently suitable for the needs of postwar Germany, and Porsche's uncomplicated and reliable car became one of the frontrunners of West Germany's *Wirtschaftswunder* (economic miracle). By the time Nordhoff died in 1968, Volkswagen AG had become the largest, most profitable company in Europe. It produced only three models: the classic Beetle, a station wagon on a Beetle chassis called the Variant, and a van. All models were still based on the original, air-cooled rear-engine design.

In 1970, VW sold nearly 70 percent of its total output abroad. Close to 570,000 units, or 40 percent of total output, were sold in the U.S. alone. This heavy dependence on one export market was an important factor in the subsequent decision to invest in the U.S. For reasons to be described below, six years later, in 1976, sales in the U.S. dropped to 201,670 units, or only one-third of 1970 levels. Furthermore, the once-profitable company lost DM 870 million in 1974 and DM 157 million in 1975.[1] It was at this time that management finally decided to build a plant in the U.S. to try and recapture its former market share.

Figure 1
Volkswagen Retail Dealer Sales in the United States
in thousands of units



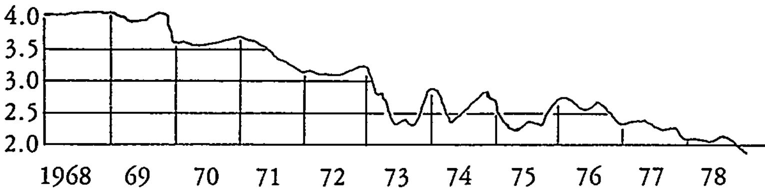
Source: *Data sheet provided by Volkswagen of America.*

1. Darrell Delamaide, "Re-tooling Volkswagen's Finances," *Institutional Investor,* (April 1978), p. 51.

Factors Leading to the Investment Decision

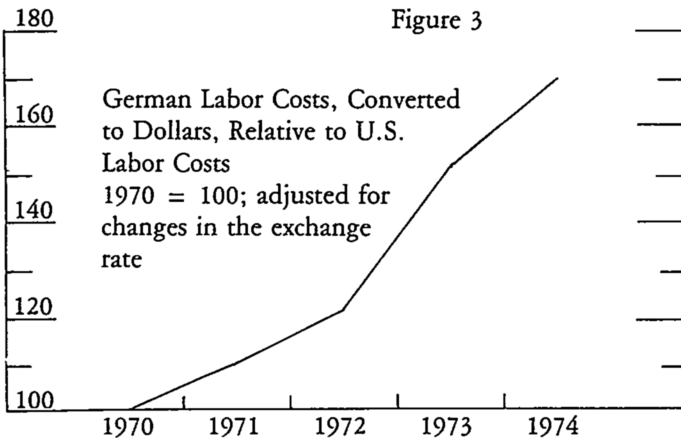
Several factors were responsible for the deteriorating market conditions and for the ultimate decision to invest in a plant in the U.S. The most obvious was that the price of the VW Beetle in the U.S. tripled in one decade from under $2,000 in 1968 to about $6,000 in 1978. This increase had several causes. First among them was the deteriorating position of the U.S. dollar vis-à-vis the German mark over a period of several years. As Figure 2 shows, while in 1968 one U.S. dollar was worth four marks, by 1978 it was worth less than two marks. This alone caused an almost 100 percent increase in price.

Figure 2
U.S. Dollar-Deutsche Mark Exchange Rates
1968-1978



Source: *International Financial Statistics*, May 1978, p. 169.

The fact that German wages increased at a faster rate than U.S. wages, when combined with other labor costs, also took a toll on Germany's stance in the U.S. market. (Although VW workers are members of the German metal workers union, their wages in the early 1970s were 17 percent higher than union-wide wages.[2])



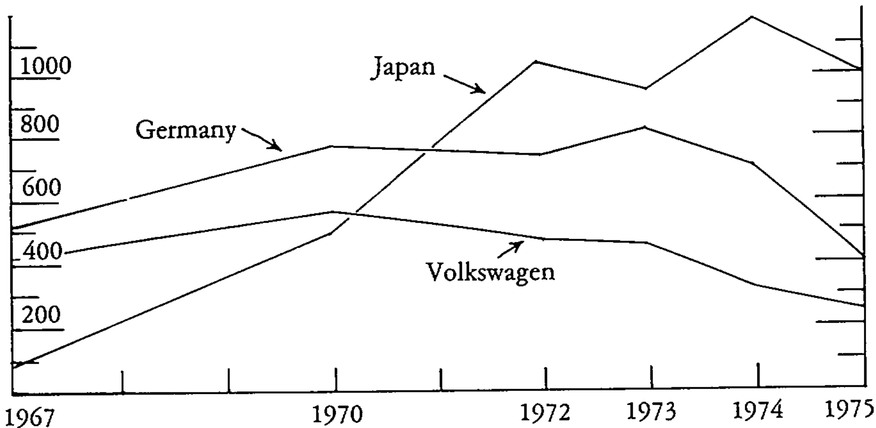
Source: *The Economist*, 12 April 1975, p. 101.

2. Alfred L. Thimm, "Decision Making at Volkswagen 1972-1975," *Columbia Journal of World Business*, (Spring 1976), p. 87.

Furthermore, a worker in Germany is allowed four to six weeks' vacation and many more legal holidays than in the U.S. Thus, while hourly wages have caught up to those in the U.S., the German wage earner works fewer days per year than his American counterpart. In addition to this extra leave a German worker also receives an extra pay check *(Urlaubsgeld)* in addition to his regular salary.

A second factor to be considered was the change in consumer tastes. For more than a generation, VW had been featuring the same narrow product mix described above. All were equipped with the same engine designed by Porsche in 1937. As U.S. and European consumers became more affluent, they wanted more than stripped economy cars. Small but plush models were being introduced by other automobile manufacturers, luring buyers away from the economy-styled Beetle. Furthermore, while buyers were moving toward more luxurious models, more manufacturers were moving into the small car market. Thus, while throughout most of the 1960s VW had the small car market almost to itself, the situation by the 1970s had changed significantly. An increasing number of U.S., Japanese, French, and Italian manufacturers were crowding into this segment of the market. Many of them were offering more options, luxury and comfort for similar or lower prices.

Figure 4
Automobile Exports to the U.S.
Thousands of Cars



Source: *Der Spiegel*, Nr.18/1976, p. 32.

A third factor was Volkswagen's distance from its major market. Volkswagens were manufactured in Europe, thousands of miles away from the U.S. This distance caused several problems. First, transporting the car from

Germany to the U.S. added $250-$300 to its cost, and duty and insurance added another $100-$150 at a time when costs were too high already. Secondly, there was impaired communication between dealers in the U.S. and the factory in Germany before and after placing orders. Dealers were unable to advise customers where their cars were, and how soon they would be delivered. The company was unable to respond rapidly enough to changing conditions. As J. Stuart Perkins, President of VW of America, pointed out: "If yellow Rabbits aren't selling, there's no way (now) to turn off yellow Rabbits in the pipeline," because of the distance between the production line and the showroom floor.[3]

A fourth incentive to invest in the U.S. plant was created by changes in economic, social and legal conditions in the United States. A recessionary period in the U.S. in the early 1970s, coupled with tight money and high interest rates, hurt automobile sales in general. A 15 percent import surcharge imposed by President Nixon hurt foreign car imports in particular.

Environmental awareness and stiffer emission controls were especially hard on the Beetle since its air-cooled engine was more difficult to modify. Laws regarding automobile design and safety accompanied by persistent debate regarding the safety of the Beetle did not help either. As noted above, all of these factors combined to reduce sales from 570,000 units in 1970 to 201,670 cars in 1976.[4] Furthermore, forecasts showed that the number of units sold in the U.S. could be reduced to "50,000 or so" by 1980,[5] if something was not done quickly. The management of VW realized as early as 1973 that if they failed to invest in a U.S. plant, they would eventually lose the American market. Therefore, in September 1973, Volkswagen established a team to study the various options open to the company.

One of the proposals was to build a completely independent facility in the United States. Under this proposal, Volkswagen would build its cars exclusively from American-produced components. The drawback of such a venture was the large initial investment. After incurring in 1974 the largest loss ever suffered by any company in history,[6] Volkswagen was incapable of making the required outlay of DM three billion. Thus the company began to investigate less costly alternatives. Licensing was ruled out because it involved selling advanced small-car technology to a potential competitor. Another alternative was to enter into a joint venture with an American manufacturer. This was given serious consideration. However, when it became obvious that losses in the German market had been reduced, the attractiveness of the joint venture began to fade. At the

3. *Quoted in:* "Why VW must build autos in the U.S.," *Business Week,* (16 February 1976), p. 48.
4. *See* Figure 1.
5. Toni Schmücker, President of Volkswagen, *quoted in* "Why VW," p. 46.
6. Since then the record has been broken by Singer which lost $451 million in 1975, and by Chrysler, which lost $1.1 billion in 1979.

end of 1975, partly as a result of VW President Toni Schmücker's efforts, and partly as a result of a good market in Germany, the company cut its losses substantially. Volkswagen abandoned the idea of a joint venture and announced that it was now considering setting up its own facility in the U.S.

The team found that a production facility in the U.S. had many advantages. While wages in the U.S. are comparable to those in West Germany, U.S. workers get fewer paid holidays and shorter vacations. In addition to the twenty to thirty additional workdays per year, absenteeism is lower in the United States. Moreover, larger suppliers and sub-contractors in the U.S. make deliveries both less expensive and more prompt.

Moving production to the U.S., the team noted, would of course also reduce or eliminate the cost of ocean freight and avoid tariffs and other import restrictions. It was also important to the U.S. market that the price of Volkswagen cars not continue to rise with the ever-stronger Deutschmark.

Political Constraints On Volkswagen's Decisionmaking

Since most of these factors were already evident at the time of the report, it is interesting to note that it took Volkswagen until 1978 to start U.S. production. This delay in investment in the U.S. plant was due to the unusual involvement of the German federal government, the state of Lower Saxony, and the labor unions in the ownership and management of the company.

Volkswagen's ownership and management scheme are unusual in several ways. As was mentioned earlier, VW was a political creation from its inception. The National Socialist regime used it first as a propaganda tool and later as a vehicular supplier to the military. As late as 1962, VW was fully owned by the German government. Today the government still owns 40 percent of the shares and is the company's largest stockholder. Half of the government's shares are owned by the state of Lower Saxony.

There are many widely accepted reasons for business to distrust government participation. Government reactions, it is felt, are generally slower than those in private enterprise. In addition, the politics and compromise that are essential to government mar the businessman's desire to base his decisions on sound economic considerations. The location of Volkswagen's first plant in the depressed area of Wolfsburg in Lower Saxony was the result of a political decision taken without regard for economic considerations. As for the relationship between private stockholders and government, it will be shown below how those two groups can come into conflict.

Beyond government involvement, Volkswagen must also contend with mandatory labor participation. Under the Co-Determination Act of 1976, German labor was given the right to participate with management in running the plant. This participation is on a parity basis (50 percent). Labor's outlook and interests

are not always in harmony with those of the stockholders or of the government. Volkswagen's Board of Supervisors has twenty members, ten from labor and ten from government and business. The ten representatives from government and business are divided as follows:

The Federal Government of Germany	— 2 representatives
The State of Lower Saxony	— 2 representatives
Business	— 6 representatives

The chairman, who comes from the business sector, has two votes. Even so, labor and government still have a comfortable majority on the board. Labor is particularly close to the Social Democrats and when this party is in power, the board is often referred to as the "Red Board."

The immediate goals and interests of these groups are not always in harmony. The stockholders, most of whom are small investors, are interested in high returns on investment and would like to see larger and more frequent dividends. The employees are interested in higher wages and better fringe benefits, as is the labor union. However, when times are bad and cutbacks are necessary, employees may prefer cutbacks in wages to layoffs; while the union, which uses VW as a pacesetter, may prefer limited layoffs to a rollback in wages for which it has fought hard in the past.

From the federal government's point of view, VW is an agent for regional development. Its primary concern is the industrialization of depressed areas (such as the East German border). The government's goals are not always economic, however, and the benefits are long-range, which means that they may not be directly related to the individual worker or stockholder.

The state government of Lower Saxony is interested in maximizing local investment and local employment; as is often true of local governments, it is more oriented toward local and short-term benefits and is very sensitive to change. This is so because closing a plant or moving it to another region has a greater and more immediate impact on Lower Saxony than on Germany as a whole. It is therefore even less inclined to see VW diversify its area of operation.

With so many diverse and conflicting interests, company decisions are often delayed and subject to horse-trading and compromise. The contradictory demands of regional development and local welfare versus the market requirements of a profit-seeking enterprise have often made decisionmaking all but impossible. In the early 1970s the situation had deteriorated to the point that only topics on which there was general agreement came before the board. Other issues were informally discussed in small groups, and voted on only when it was felt that there was already consensus. However, at times board members would strongly support an issue privately only to vote against it later to avoid antagonizing an influential board member. As Alfred Thimm points out: "Individual VW executives, in turn, often seemed primarily concerned with seek-

ing approval of important board members and adjusted their behavior accordingly."[7] When times were good and there were enough funds to satisfy all needs, these conflicting demands were seldom visible. Not until times changed and cutbacks were required did the conflicts become apparent. Hence, the decision to invest in the U.S., at a time when VW was in trouble financially, was postponed and barely made in time.

The Move to America

Between the years 1948 and 1968, VW grew rapidly under the leadership of Heinrich Nordhoff. The combination of strong leadership and a long period of prosperity made it easier to smooth out contradictions and conceal inconsistent demands. However, when Kurt Lotz became chief executive officer in 1968, after the sudden death of Nordhoff, it became evident that the company would have to widen its narrow product mix to satisfy the demands of increasingly affluent buyers and to meet the growing competition. In 1969 Lotz bought the Audi NSU automobile company and was immediately faced by the same political constraints and economic horse-trading that he and his successors were to meet in subsequent years.

In exchange for their vote to approve the NSU acquisition, the representatives of the state of Lower Saxony on the Board of Supervisors of VW demanded that the company build a new DM 600 million factory in Lower Saxony.[8] There was no need for a new factory and no economic justification for its construction in that region. NSU had two established plants there in addition to the existing VW plants. More important to the state representatives, however, was the upcoming election and the risk that the ruling Christian Democratic government would be upset. Therefore they allied with representatives of the federal government and the unions to dispense a substantial pre-election gift for the local community.

Despite construction of the new factory, the Christian Democrats were defeated. The Social Democrats carried Lower Saxony, and the union-government alliance with their clear majority of the board soon passed a 17 percent wage increase. The VW K-70, built in the new 600 million DM factory in Salzgitter, Lower Saxony, proved an expensive failure. The big investment that the union-government coalition had forced on Lotz cut deeply into the finances of the company. The new majority on the council was quick to find the culprit, and fired Lotz in 1971.

The new chief executive, Rudolf Leiding (1971-1974) had a reputation as a technological innovator and an iron-fisted administrator. He was instrumental in expanding the VW product line by adding the Dasher, Rabbit and Scirocco.

7. Thimm, "Decision Making," p. 99.
8. *Ibid.*

These models, featuring front-wheel drive and water-cooled engines, represented a departure from those previously sold in the U.S. They were well adapted to modern assembly procedures, had many interchangeable parts and represented the state of the art in automotive engineering.

Above all, however, the new models presented a new image. In addition to the company's traditional trademarks — reliability, economy and superior engineering — VW for the first time began to signify luxury and performance.

Leiding soon realized that the American market would be lost if VW did not begin production in the U.S., but he too underestimated the political constraints imposed by the board. After a comprehensive study, Leiding presented his plan for a U.S. facility to the Board of Supervisors in 1974. The timing was unfortunate, since 1974 was the worst year VW had ever experienced. The fuel crisis had hit the German automobile industry hard and without warning, and passenger car production dropped from 3.6 million in 1973 to a 1974 level of 2.8 million. While Volkswagen's sales held steady, it was financially pressed since it had just finished expanding its productive capacities to make room for the new models. As a result, inventories were piling up fast. In addition, the unions forced through an 11 percent wage increase at a time when Volkswagen was already laying off workers by the thousands in an effort to reduce losses. Although the union and the government representatives on the board publicly vowed to fight any layoffs, 25,000 workers were nevertheless laid off when it became evident that the survival of the company was at stake.[9] In April, half of Volkswagen's work force stayed home for two weeks. The firm began to offer up to DM 3,500 to any worker who would quit voluntarily.

Against this background, Leiding's proposal to spend a billion dollars in the U.S. caused a storm of protest. Eugen Loderer, the ranking union representative on the council, declared his intention to prevent by any means available the exportation of jobs. The state government of Lower Saxony was equally determined to block the move. The financial situation of the company, moreover, had deteriorated to such an extent that it would have had to issue additional stock to finance the project. The need to manufacture in the U.S. was obvious, but the political realities of the issue, even ignoring financial difficulties, prevented approval of Leiding's plan.

Opposition to the plan developed even within Leiding's own management team. On 22 October 1974 Leiding called for a vote of confidence from the Board of Supervisors, stating that he would resign if the vote was not unanimous. When it became clear that the vote would be far from unanimous, Leiding resigned. The plan for a U.S. facility was shelved.

The new and present chief executive, Toni Schmücker, was faced with a somewhat more favorable economic and political situation. Among his advan-

9. Robert Ball, "Volkswagen Hops Rabbit Back to Prosperity," *Fortune*, 13 August 1979, p. 122.

tages were a diversified line of products, improving economic prospects in Germany, and the fact that he was a much more capable politician and diplomat than Leiding.

Nevertheless, Leiding's bluntness had yielded some benefits for Schmücker to reap. Leiding had forced the vital issues out into the open. He had taken the brunt of politically motivated wrath and paved the way for a more diplomatic manager. In fact, his departure coincided with a softening of opposition to the U.S. plant. Schmücker seized the opportunity. By making the common interests of other groups explicit and emphasizing them, he succeeded in effectively isolating the union representatives, the last strong resisters.

Stockholders, for example, were already increasingly concerned about the profitability of the company, which had not paid dividends either in 1974 or 1975. They supported the move to restore profitability in the largest foreign market, the U.S., as a step toward the overall improvement of the financial health of the company.

The German federal government was amenable to the idea too, but for different reasons. Support for steps to restore profitability to the large firm would bring the Social Democrats much-needed support among middle-class voters. The government could afford to be unconcerned about the loss of jobs to the U.S., inasmuch as most of the affected workers were non-voting "guest-workers." The unions did not constitute much of a problem either, being unwilling to forego their traditional link with the Social Democrats.

The recent election of the moderately conservative Christian Democrats in Lower Saxony had already dealt a blow to union influence. Hence the union found itself outvoted and outmaneuvered. In addition, it faced a major constraint: it did not want to force a confrontation that might crystallize a lasting anti-union coalition. The union's ultimate weapon, a strike, was too dangerous a step to take in an election year. If the unions flexed their muscle at that time, they might precipitate a conservative victory in the election, which would bury all hopes for passage of the much-desired Co-Determination Act. Hence, their only alternative was to cooperate. As a consequence of those concurrent forces, when the U.S. project was finally brought to a vote in April 1976, the council approved it unanimously.

Negotiating an Agreement in the U.S.

The news that VW was planning to establish a facility on the American east coast immediately generated considerable excitement. In the words of a U.S. Commerce Department source: "Virtually every state east of the Mississippi is interested, and nearly every one of their governors has been to Germany to woo VW."[10] Governors, mayors, state development officers and local businessmen

10. *Wall Street Journal*, 22 April 1976, p. 1.

approached VW with attractive offers. These included an original joint proposal by Tennessee, Arkansas and Mississippi. These states agreed to spread evenly among them the backward linkages that a new auto plant could be expected to induce. Puerto Rico, for its part, offered VW an extremely attractive package, including tax exemptions and subsidies for manpower training and transportation. Observers termed the interest and competition particularly intense, as the *Wall Street Journal* noted: "The three-year courtship has become ever more impassioned, and lately some suitors have become increasingly less gentlemanly toward other suitors."[11] Volkswagen's financial condition after two consecutive years of losses in 1974-1975 led to the abandonment of any plan to build a new plant from scratch. Hence the choice was narrowed down to two possibilities: an old General Motors tank assembly plant in Brook Park, Ohio; and a partially constructed Chrysler assembly plant in New Stanton, Pennsylvania.

Brook Park appeared to be the early favorite. Set-up costs would be lower, and the facility could be ready for production within a year, while in New Stanton a larger investment would be necessary. In April, the German weekly *Der Spiegel* even showed a photograph of "Volkswagen's future facility in Ohio."

Consequently, Pennsylvania decided to improve its offer. In contrast to Ohio, Pennsylvania's bid was being promoted by the governor himself. Governor Milton Shapp had decided to enter the Democratic presidential primary. If he captured VW, a definite publicity windfall would result. Pennsylvania decided to make Volkswagen an offer it could not refuse, and finally won the bid; but many critics questioned whether the state could afford such victories.

Pennsylvania committed itself to the following package: The state would buy the old Chrysler plant for $40 million and then lease it to VW, and spend $30 million on highway and rail construction to the plant. Pennsylvania would also waive 95 percent of all local taxes in the first two years and 50 percent of all local taxes in the following two, and give Volkswagen a $135 million loan at nine percent interest. The money would come from pension funds of the state school teachers and other employees.

Criticism and misgivings about the plan were widespread. The trustees of the pension plans were reluctant to enter the deal but yielded to strong pressure from the state capital. An editorial in *Pensions & Investment* magazine stated: "The trustees should not . . . have to consider anything more than investment criteria when making an investment decision. They owe no loyalties to anyone but the members of the pension plan."[12] Other critics pointed to the fact that out of the total investment package VW was proposing, 80 percent would be provided by Pennsylvania and only 20 percent by Volkswagen. "Nobody really knows what the bottom line is," complained Senator Richard A. Tilghman, a

11. *Ibid.*
12. *Dun's Review*, September 1976, p. 52.

minority Republican. "We don't know how much money is needed, how it's going to get there, who's going to own what."[13] On 17 August 1976, the *Wall Street Journal* ran an editorial under the title "Rabbits in the Cabbage Patch" which said:

> But the best test of such judgments is the amount of private capital attracted, and that is largely absent in this case. . . . Finally there is the question of competition. Attracting Volkswagen to Pennsylvania may make that state's governor look good, but who will pay the bill? Other Pennsylvania taxpayers, no doubt. And American automakers, perhaps, to the extent that they find it difficult to compete with a subsidized producer. The most recently constructed GM plant, at Clinton, Mississippi, was built with no subsidies and pays full taxes.

On 2 March 1977, reinforcement construction began in the New Stanton plant.

Legal and Social Problems

No sooner had VW begun preparing its plant than it confronted political and regulatory realities in the U.S. The Environmental Protection Agency (EPA) ruled that hydrocarbon pollution throughout Pennsylvania was well above the federal limit, and that unless Governor Shapp and VW found a way to make the amount of hydrocarbons emitted from the proposed plant's paint spraying operations acceptable to the EPA, VW might not be allowed to make a car there.[14]

The EPA and VW were not strangers. Volkswagen had first felt the EPA's bite while it was still selling Beetles. In fact, the EPA had been instrumental in the demise of the Beetle because the latter could not economically be converted to meet the new emission standards. At one point the EPA had threatened VW with a recall of 1.4 million Beetles.

Since Volkswagen was already installing the most advanced technology available in its plant, it was irritated with the EPA's most recent attack, especially since nothing had been said about this problem before or during the long negotiations. In a short statement the attorneys for VW said, "Our engineers are now evaluating the current EPA rulings to determine what effect, if any, they might have on the plant or on the operation of any new industrial plant in that or a similar area of this country."[15] Volkswagen was already late in starting operations in the U.S. and could not afford further delays for drawn-out studies and meetings. The EPA was not impressed. Warned Howard Heim, chief of air

13. "Financing troubles for VW's new plant," *Business Week*, 5 July 1976, p. 26.
14. "Pollution may kill VW's Rabbit plant," *Business Week*, 7 March 1977, p. 26.
15. *Ibid.*

programs for the EPA in the region: "To say that the VW plant will be stopped because of this is premature, but it is a possibility."[16]

The problem was finally resolved through the "trade-off" policy which provided that pollution in one area could be reduced to compensate for other areas with pollution above permissible levels.

This was not the only problem VW experienced with the U.S. bureaucracy. In 1975 the Treasury Department began an investigation of alleged dumping by Volkswagen. In 1974, it was charged, VW cars were cheaper in the U.S. than in Germany and the company lost money on each car it sold in the U.S. As soon as it became evident that VW would set up shop in the U.S., however, the investigation was stopped.

Volkswagen's problems were not over. The labor problem still had to be dealt with. Blacks demanded explicit minority hiring. A coalition called the Volkswagen Coalition, made up of Pittsburgh civil rights organizations, the Urban League, eight NAACP chapters, and church groups set up picket lines in front of the plant demanding a 25 percent minority hiring ratio. VW's management responded that black representation on the work force (6.9 percent) was higher than its representation in the surrounding area. The coalition also demanded that VW hire blacks from Pittsburgh, provide them with transportation to make the seventy-mile round trip, and set up day care centers.[17]

Local residents objected to these demands. They felt that they should have hiring priority, and worried that their area would turn into a "little Detroit" while outsiders would enjoy the job benefits. Volkswagen was thus caught in the middle of legal and social problems even before it opened its gates.

Volkswagen: A Pacesetter for Other Foreign Investors?

The problems plaguing VW in the last decade were not unique. Japanese, Dutch, Swiss and other foreign companies experienced similar difficulties. While the dollar lost 55 percent of its value vis-à-vis the German mark between 1968 and 1978, it also lost 50 percent of its value vis-à-vis the yen, 65 percent against the Swiss franc, and 46 percent against the Dutch guilder. Within a few years products produced in these countries doubled in price for U.S. consumers.

As in the case of Volkswagen, the cost of labor increased in other Western countries faster than in the U.S., pushing prices even higher. Freight charges and customs duties (which are determined in most cases as a percentage of the price of the product) made already costly items even more expensive.

The declining dollar and the rising operating costs of foreign firms had a

16. *Ibid.*
17. *Ibid.*

dual effect: first, it became more difficult for them to sell their exports in the U.S.; and secondly, it became less expensive to set up a plant in the U.S. or to acquire controlling interest in an existing one.

There were other reasons why many foreign companies were contemplating the same move as Volkswagen. In the first place, thirty years of uninterrupted growth had transformed many small foreign firms into strong multinational enterprises with ample capabilities to invest in new enterprises abroad. Volkswagen had had a head start before World War II, but other foreign firms were catching up fast.

Secondly, corporate mergers and consolidations within important industries in Western Europe and Japan during the late 1960s added to the ability of foreign firms to use economies of scale in production, marketing, and research and development. Foreign investment and global optimization of resources became more common. As shown in Figure 5, total sales of the two hundred largest foreign companies in 1964 equaled 45 percent of the total sales of the two hundred largest U.S. industrial corporations, but during the next ten years sales rose nearly twice as rapidly as those of their U.S. counterparts.

Figure 5
Growth in sales of the 200 largest non-U.S. and the 200 largest U.S. industrial companies

	1964	*1969*	*5 year % growth*	*1974*	*5 year % growth*
Total Foreign	108	228	111%	611	168%
Total U.S.	239	368	54%	689	88%

Source: *Foreign Direct Investment in the U.S.*, Volume 5, Appendix G, p. 31.

A third reason for foreign companies to invest in the U.S. is that after two decades of trade with the U.S., foreign firms have become familiar with the American market and with the way of doing business in the U.S. As their products have gained acceptance and their familiarity with the American consumer has increased, lower risks have made direct investment more attractive.

Finally, capital flight from Europe has been encouraged not only by diminished controls on outflows of capital, but also by concern over the prospect of electoral gains by Socialist parties, especially in Italy and France.

In addition to these recent developments there were more traditional factors that made the U.S. an attractive place in which to invest: the size of the market, the political stability of the country, the availability of skilled labor at competitive prices, the sophisticated capital markets where credit is available, often at a lower cost than in other countries, and the efficient network of distribution. At the end of 1978 foreign direct investment in the U.S. exceeded $40 billion.

There were some negative developments too. The regulatory atmosphere in the U.S. and the numerous permits some businesses were required to obtain made potential investors cautious and highly selective. Therefore, Volkswagen's troubles with federal and state agencies were carefully watched by potential investors.

Expectations for the new Volkswagen plant's early performance have been largely fulfilled. Sales in the U.S. were up 45 percent in 1979.[18] A second shift was recently added, production has climbed to around a thousand units per day, and VW plans to expand daily output to 1,040 cars by the end of 1980.

Despite minor labor difficulties, the price, quality and delivery of cars from the U.S. plant has been good. Volkswagen's management is planning to expand its U.S. productive capacity by opening a second plant on the site of a missile factory in Michigan.

If Volkswagen's U.S. operation continues to show success, it is doubtful that the Japanese automakers will sit still and let VW take the market away from them. Two of the five major Japanese automakers — Nissan and Honda — have revealed their investment plans. Nissan intends to build light trucks at a site yet to be determined. Honda, in a more ambitious venture, has announced that it will construct a $200 million plant in Ohio.[19] Toyota, which already has a plant manufacturing truck beds in Southern California, has commissioned three major consulting firms to analyze the feasibility of another U.S. auto manufacturing investment.

As Detroit shifts its productive capacities away from large vehicles toward small cars, the competition which foreign manufacturers face in the U.S. market will intensify. Consequently, the pressures to exploit the advantages of U.S. production for U.S. sale can also be expected to heighten.

The United States — the origin of much large overseas investment in the 1960s and 1970s — may thus develop into a major host country for foreign investments in the 1980s.

18. United Press International report, 5 July 1979.
19. *New York Times*, 1 May 1980, p. A3.