The Future of Investment Controls

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Since 1965 when President Johnson announced his "Voluntary Cooperation Program for Business" and the "Voluntary Foreign Credit Restraint Program" through January 1, 1968, when the bulk of these programs became mandatory,[1] the United States has fought what was up to the week of November 11th, 1968 a losing battle with our balance-of-payments. In the two decades since the close of World War II, the United States has been thrust into the role of the advocate of free trade; liberalizer of tariff and non-tariff barriers; the prime mover behind *GATT;* the reconstructor of Europe and the developer of emerging countries. Such awesome responsibilities were not without their cost and adverse effects, particularly where our balance-of-payments was concerned. During this period of time, our payments were in deficit almost every year. This chronic problem became acute in 1966-1967, when it became apparent that the rapid increase of United States business expansion abroad, coupled with increased consumer demand for imported goods at home and a greater and more expensive military involvement overseas, were producing an ever increasing number of red ink entries in our payments ledger. Hastily, the United States government moved toward greater involvement in international business affairs by applying what Representative Wilbur Mills, in another context, has referred to as "a Bandaid for a hand cancer."[2]

It quickly became apparent that something more in the nature of a tourniquet was required, and the problem was attacked on several fronts, none of which to date has really been instrumental in alleviating the chronic problem. The difficulty in accurately evaluating the current effectiveness of investment controls lies in the ingrained habit of both the press and certain government officials to use different guidelines when reporting the current state of affairs in this area — for example, *Business Week* in its November 2, 1968 issue reported:

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[1] Executive Order 11387, Jan. 1, 1968 and *Foreign Direct Investment Regulations,* CCH Bal. of Pay. Rep. (1968), ¶ 515, p. 508. U.S. Dep't of Comm. Regs. §§ 1000.101 — 1000.804.

[2] *The New York Times,* Nov. 16, 1968, p. 16, col. 1.

> The U.S. trade balance looks a bit better, but the improvement won't prevent another heavy deficit this year in the balance-of-payments. Exports topped imports by $282-million in September on a seasonally adjusted basis... The September bulge pushed the trade surplus for the first nine months to $834-million. If the gain continues... the year's surplus will hit $1.5-billion.[3]

However, further down on the same page the magazine points out on the rather pessimistic note:

> It's a good bet that the payments deficit for the year will be more than $1.5-billion... But these figures are calculated on a 'liquidity' basis, and they are dressed up by special transactions, mainly purchases of medium-term Treasury bonds by Germany and other foreign governments.
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> If you exclude special transactions, the improvement over 1967 isn't so great as it looks. These special inflows totaled about $1.4-billion in the first nine months of this year, compared with only about $600-million in all of 1967. Leaving them out of account, as some experts do, probably would push the deficit this year to $3-billion or more, compared with $4.1-billion in 1967.[4]

The New York Times of November 16, 1968 in a somewhat guarded text reaches about the same conclusion but couples the payment surplus with a Commerce Department announcement of slight liberalizations in Foreign Direct Investments Control.[5] The initial impact of this article provides a soft glow of optimism. During the interval *The Wall Street Journal*, in reporting statements made by Mr. Nixon's advisor on balance-of-payments policy, Gottfried Haberler, states that "Ending curbs on business spending abroad wouldn't hurt the economy."[6] Meanwhile, incumbent government officials and spokesmen for the current Administration run the gamut from predicting vast improvements, which they attribute to the effectiveness of the investment curbs, to dire forecasts that if the controls are removed the nation's economy will suffer a severe recession and sizable unemployment. They concede that certain liberalizations may be granted in light of some improvement in our trade balance but that the situation is far from corrected.

It is no surprise that general agreement on solving the payments problem is virtually impossible — tied as it is to numerous complex components, which individually can be a large-scale problem. Trade balances (about which much enthusiasm is currently shown since they show a current surplus) are but a small part of the total. The same is true of foreign investment in the United States, which in this last quarter amounted to $990 million. This is two-thirds greater than the amount of net purchases of foreign securities by Americans

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[3] *Business Week*, Nov. 2, 1968, p. 111.

[4] *Id.*

[5] *The New York Times*, Nov. 16, 1968, p. 1, col. 2.

[6] *The Wall Street Journal*, Nov. 15, 1968, p. 2, col. 3.

during the same period. In the area of investment controls, their purported effectiveness must be weighed in the light of the higher earnings on foreign investments which United States business have been earning. A consideration of all these factors perhaps leaves less room for the current optimism than is justified. For example, in the area of trade balances the performance of the United States, allowing for its greater amount of foreign trade, is not really significantly better than that of Canada, whose favorable trade balance continues. Canada's trade balance increased almost $90 million in September, even though imports increased 20% during the same period. For that portion of 1968 ending in September, Canada's trade surplus was increased by some $700 million over the previous year.[7] This is apparently further evidence of the symbiotic relationship between our two countries, since Canadian officials attribute this rise to the "exceptional buoyancy of the United States economy".[8] Considering that about 30% of the total capital investment in Canada is from the United States and that capital in-flows into Canada during the past ten years has averaged $1 billion,[9] this is not too surprising. What this actually means is that the United States controls 60% of Canada's productive capacity, and in terms of capital stock, 59% of manufacturing industries, and 79% and 77% of the petroleum and natural gas industries, respectively.[10] But since Canada is specifically exempted from United States Foreign Direct Investment Controls, *any* changes in these regulations will have little impact upon Canada, solely from the change itself. However, any change that elimination, liberalization or tightening of our Foreign Direct Investment Controls would have could not but be felt in Canada. This is particularly so if Mr. Nixon carries into effect his campaign statement that he intends to eliminate these curbs. It is difficult to foresee any other result than that such elimination would of necessity require a reduction in domestic spending to curb inflation. This, in turn, would result in a slowdown of the United States economy which would reduce the attractiveness of United States investments to foreign investors. However desirable domestic restraints upon the economy might seem to some, the solution to our economic troubles does not rest upon one or two problem areas. Instead, it is dependent upon numerous variables, including but not limited to: increased exports, reduction of non-tariff barriers in the United States and

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[7] CCH Bal. of Pay. Rep., Report Letter No. 25, Nov. 8, 1968.

[8] *Id.*

[9] *Private Enterprise in a Changing World*, XXIst Congress of the International Chamber of Commerce, (Paris, 1967), 32, at p. 33.

[10] *Id.*, at p. 32.

elsewhere, the gold policy to be pursued by the new Administration, control of the wage-price spiral, early implementation of Special Drawing Rights, and solution of various internal labor problems which have international overtones. It should be pointed out that one factor which has contributed to the current surplus in the United States trade balance has been the impetus to exports given by the threatened longshoremen's strike, scheduled for early December, when the current Taft-Hartley injunction expires. Many exporters rushed their shipments to avoid the expected long tie-up, thus providing a temporary but not sustained boost to the United States export picture. Predictably, this will level off and probably drop after the first of the coming year.

Further complicating the economic picture and the United States' world position is the fear that the new Administration may become increasingly protectionistic and may move for import quotas in steel, textiles and chemicals. Currently, trends in this direction are apparent even without the change in Administration, and the United States may find itself taking the defensive on charges of violation of the *General Agreements on Trade and Tariffs*. Recently foreign cheese exporters have experienced a sizable decline in their exports to the United States as a result of exercise of waiver privileges by the United States to protect its cheese producers who have a considerable surplus on hand. Any of these moves, although ostensibly within established *GATT* provisions, may be condemned as violative of its actual terms. Such allegations, even if baseless, are often the basis for retaliation by foreign governments which would have a deleterious effect upon United States exporters.

Again outside the area of investment controls has been the development within the past year in Europe of changes in the tax structure on imports from outside the Common Market countries, particularly the new German *Added-Value Tax*, which is adding to the burden of American exporters. One obvious way around this problem is to establish a foreign-based operation, but moves in that direction are seriously curtailed by the present FDI regulations. The new proposed liberalizations, particularly the optional investment quota, should be useful to a business commencing its maiden foray into the foreign-based operation.

The essential fact in any discussion of foreign investment, foreign trade, foreign exchange, economic development and balance-of-payments is that each of these is but a part of the over-all international economic picture, and consequently improvement or deterioration in any one or two of these will not necessarily result in a favorable or unfavorable economic position. Therefore the world's economy is, like the law, a seamless web. Granted, variations of some magnitude as between countries will always be present, and, on a short-term basis, improvement in any of the respective components will register as a favorable indicator in the over-all situation. Unfortunately, governments tend to suffer a degree of myopia when they assiduously apply their efforts to one or two of the components in the mistaken belief that these are actually the total problem instead of symptoms. Like symptoms of disease, they too must be treated if total recovery of the patient is to be achieved.

Economic difficulties (if the medical analogy may be pursued) are often easy of diagnosis but do not lend themselves to simple treatment. Like heart disease, they are better prevented than treated. Economic transplants, like anatomical ones, are often not successful. As conflicting diagnosis and prescribed or accepted modes of treatment vary between practitioners of the healing arts, so it is with the economists. Nor does the analogy end there — it was Walter Bagehot, who in describing the intricacies of international finance, entered the caveat that "we must not let in daylight upon magic," a dictum not unknown to the medical arts. The time is long overdue to cease regarding international economic policy and international finance with wonderment and awe. Shrouding a nation's fiscal and trade policies in a cloak of mysticism, the understanding of which is denied all but the initiated, is at worst suicidal and at best foolhardy. It is not promotive of international understanding, and it most certainly is not conducive to the establishment of workable procedures which will insure the stability and prosperity of the world economy. Ignorance, as much as self-interest, has dictated much of the United States' economic policies in the past several decades. Often it has been a case of policies adopted too late or in too little quantity or worse the right policy at the wrong time or extremes which sate but do not correct. Much of this type of rationale permeated the current Administration's balance-of-payments program, and it can be hoped, but probably not expected, that after January 20, 1969 that a more reflective solution will be forthcoming. Currently, the United States is astride a rapidly expanding economic crevasse, which *The New York Times* has described in the following terms:

> The President's new balance of payments program, in fact exposes the central dilemma of American financial policy like a raw nerve.
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> On the one hand, the United States is in the position of a successful but badly overextended banker. The nation has a wealth of productive and highly profitable long-term investments abroad, but its stock of cash to meet withdrawals of international deposits on demand has dwindled alarmingly.

> ... On the other hand, a prime source of strength in America's dealings with the rest of the world has been the great productivity of its foreign investments. Not only is there a very large return flow of earnings... but also the expansion of United States companies abroad tends to build American exports.
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> Thus, to protect the position of the United States as an 'international Bank' — and hence, too, its role as a world financial leader — the President has been forced to impose restrictions that could well undercut the foundation of its international economic strength.[11]

Again, it is pointed out that investment controls are but a part of a much larger problem.

If economic development is to continue toward the point where in the year 2000 many of today's highly industrialized nations will have passed into the new era of being post-industrial, where studies by the Hudson Institute and the American Academy of Arts and Sciences have shown the society to be characterized as:

1. Possessed of a per capita income about fifty times the preindustrial.
2. Having most 'economic' activities as tertiary and quaternary (service-oriented) rather than primary or secondary (production-oriented).
3. As a society where business firms are no longer the major source of innovation.
4. Having more consentives as against marketives.
5. Having established an effective floor on income and welfare.
6. A society in which efficiency is no longer of primary concern.
7. Having an increased role for the public sector and a diminished role for the market.
8. Having widespread 'cybernation.'
9. Finally achieving in fact the 'small world.'
10. 'Doubling time' between three and thirty years.
11. A learning society, where by far the greatest emphasis is upon education.
12. Possessing rapidly improved educational institutions and techniques.
13. Experiencing erosion in the middle class of work-oriented, achievement-oriented, and advancement-oriented values.
14. Also experiencing erosion of 'national interest' values, and
15. Witnessing the ascendency of a central position of sensate, secular, humanist, and perhaps self-indulgent criteria.[12]

Such developments require, among many others elements, the intelligent utilization of capital. It is to this factor that this segment of this two-day program on International Resources is devoted. After all, the problem of investment controls has but one goal —

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[11] Heinemann, "Monetary Storm is Gathering Force", *The New York Times*, Jan. 7, 1968, Sec. 3, F1, col. 7.

[12] H. Kahn & Wiener, *The Year 2000*, (New York, 1967), p. 25.

the regulation of the flow of capital, and proper flow is essential to the intelligent utilization of that commodity.

All private foreign investment begins and hopefully ends with money. It is private foreign investment which is the catalyst of economic development, and the sensible creation and deployment of capital will determine whether the investment will succeed. No one really need be told the importance which money plays in the success of any venture, but perhaps a few figures will be instructive. In just the area of foreign investment in developing countries from 1957 to 1967, a total of $80 billion flowed into those countries, $30 billion of which was the result of United States private investment. Naturally, both private aid and governmental aid are necessary in economic development, but the capital flow from private sources, direct investment and commercial banks spells the difference between economic success and only moderately thriving economies. In Latin America, for example, 40% of its total exports are from industries created by United States investments. The crucial need for further foreign direct investment to aid economic development was not lost sight of when the present mandatory curbs were enacted, as witness the Schedule A countries which permit inflows of capital from the United States to be added to reinvested earnings provided it does not exceed 110% of the company's average investments in those countries during the base period 1965-1966.

At this point it may be useful to outline the priorities with which foreign trade and investment should be concerned. First, strengthening of the domestic economy of the investor's own country through the returns on the invested capital. Second, working to increase the individual investor's wealth. Third, promoting the economic development of the country and countries in which the investment is made. Fourth, developing a healthy and stable international economic situation, kept so through sound monetary policies and an extremely high degree of international cooperation.

It was to the first of these that the FDI regulations were principally directed, but the priority was subjected to a Procrustean treatment which can be best be described as shortsighted. The eagerness with which the United States Government sought to immediately recapture private return on investments was voracious but hardly sensible. The FDI regulations, though billed as being the major step toward correcting the major source of capital outflows which were jeopardizing the United States monetary reserves, cast the United States in the role as slayer of the proverbial gold-laying goose. It is not a course of wisdom to curtail the activities of businesses which have been returning capital to the United States at an annual rate of $8 billion since the end of World War II. Furthermore, governmental myopia was again evidenced by the misrepresentations which served as justifications for imposing mandatory curbs. Overlooked was the basic fact that, just because certain gaps in our international trade position existed, this did not give *per se* the United States a totally unfavorable trade balance. Nor was it pointed out that the entire system of international trade consists of interlocking surpluses and gaps among trading partners. As Irwin Robinson, editor and publisher of *Travel Weekly* (a trade journal for the travel industry) pointed out:

> The fact is that imbalances in specific commodities and services are inherent in — and essential to — international trade. If each country didn't have specialties in which it excelled, there wouldn't be any international trade.[13]

If the United States' trade balance has recently been in deficit, that is usually only a short-term problem and within the last quarter has been converted into a surplus. However, our balance-of-payments problem is still with us and there is no evidence to prove conclusively that the FDI regulations were any more or less responsible for the lesser deficit. This in essence is the crux of the entire subject of international trade and finance — no one can agree on the best specific methods of assuring continued improvement. In fact, about the only absolute source of agreement is that the proper balance between inflows and outflows of capital is essential for a properly functioning international as well as domestic economy. The goal but not the means seems, then, to be the only item which is clearly defined.

Assuming that curbs on foreign investment are one way to accomplish the asserted goal, let us examine the basic pattern of these regulations in the attempt ultimately to be in the position of assessing their effectiveness.

The regulations governing Foreign Direct Investment derive from Executive Order 11387 and the January 1, 1968 statement of President Johnson. Basically, the FDI regulations contain four major elements. One, new direct investment to continental Europe and certain developed countries (Schedule C) were barred in 1968, but some discretion is permitted in applying the regulations as regards existing and proposed investments. Two, new net investment in other developed countries (Schedule B) is limited to 65% of the 1965-1966 average. Three, new net investment in the developing countries (Schedule A) is limited to 110% of the 1965-1966 average, and four, United States investors were required to repatriate earnings in line

[13] *The New York Times*, Feb. 19, 1968, p. 27.

with their 1964-1966 practices. Positive foreign direct investment on a worldwide basis was limited to a minimum authorization level of $200,000 — in the original regulations this was $100,000. This was intended to reduce the number of companies which under the original authorization were required to obtain specific approval of the Office of Foreign Direct Investment (OFDI). This has been the only substantive change in the regulations since they were announced in January of 1968. These extremely complex regulations have been subject to a welter of change during the past eleven months, but, with the above exception, all were procedural in nature and were designed for clarification. Obviously, where the changes were intended to clarify, certain substantive changes did occur as a by-product. As of today, five significant departures from the original regulations are apparent: (1) the increased minimum authorization; (2) a changed repatriation of earnings test which no longer, with the exception of Schedule C countries, requires basing repatriation upon a company's practice during the base period 1964-1966, but actually the old test may have been retained through the broader definition accorded to Positive and Negative Direct Investment; (3) Canada was exempted from most of the limitations and restrictions, which if applied might, it was felt, cause increased borrowings by Canadian entities in the United States capital market; (4) unused authorizations under certain circumstances could be carried over into a subsequent year or, in the case of Schedule C countries, subsequent years, or it is possible to carry over as between different Schedule areas in a "downstream shift"; and (5) foreign borrowing proceeds generally are required to be expended before other investment authorizations may be made. As to (5), since the regulations permit investments from foreign borrowings to be made, it is of interest to note that in the first half of 1968 American companies borrowed abroad through bond issues $1.1 billion, but as of September 20, 1968 $900 million of this has *not* been used to finance foreign direct investment.[13a]

[13a] Since the writing of this article several substantive changes of some magnitude in the *Foreign Direct Investment Regulations* have occurred. These changes, it is felt, will ease the previous inequities caused by the controls and will result in a substantial decrease in the U.S. balance of payments deficit.

These changes which were of effective January 1, 1969 raise the minimum quota from $200,000 to $1,000,000, and fix at 30% the optional earnings allowable based on 1968 earnings of foreign affiliates. Additionally, the new changes permit small and medium-size investors to file only one report in 1969 in contrast to the previously required quaterly ones, and extend to the extractive industries fairer treatment in respect to exploration and development costs. Finally, in an attempt to minimize disruptions in the air transportation industry caused by

As late as September of this year there was uncertainty as to whether the announced objective of the FDI regulations — reduction by $1 billion of the United States payments deficit could be accomplished. Since the restrictions are tied to the balance-of-payments statistics as evolved by the International Monetary Fund, it will be well into 1969 before any effectiveness of these curbs can be measured. Here it should be noted that since a specific statistical result is sought, the rules as to accounting and to prohibited transactions are not always seemingly logical, and this tends to explain the complexity of the regulations.

In all probability additional restraints will be sought in what may be a futile attempt to come to terms with the elusive payments problem. If William Chartener, Assistant Secretary of Commerce for Economic Affairs, is to be believed, it will be exceedingly difficult for any Administration to avoid this if the United States is to hold its overall balance-of-payments deficit to a figure well under $2 billion.[14]

The regulations are now totally self-contained and cannot be overridden by Executive Order, a fact which certain recent campaign oratory failed to convey. Section 201(b) of the regulations provides that all transactions prohibited by Executive Order 11387 which are not prohibited by Section 201 are authorized. The current structure completely prohibits: (A) positive direct investment by a direct investor in affiliated foreign nationals (AFNs) of such direct foreign investor in Schedule A or B countries; (B) positive net transfer of capital in Schedule C countries; and (C) reinvestment by a direct investor of any portion of its earnings of incorporated affiliated foreign nationals in Schedule C countries unless excepted by Section 503 ($200,000 *de minimis*) or Section 504 (authorizations or exemptions) or by the Secretary of Commerce.

The regulations consist of eleven subparts and seventy-four sections, only four of which are operational or substantive, the remainder are either definitional, procedural or designed for implementation of Sections 201 (Prohibitions), 203 (Liquid Foreign Balances), 503 (Positive Direct Investment not exceeding $200,000), and 504 (Authorized Positive Direct Investment in scheduled areas).

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the introduction of jumbo jets, the *Regulations* now permit the 30% earnings quota to be used on a global basis without regard to the three geographical schedules.

These liberalizations are considered as consistent with President Nixon's announced desire ultimately to dismantle the present system of direct controls. See CCH Bal. of Pay. Rep., Report Letter No. 39, April 7, 1969.

[14] CCH Bal. of Pay. Rep., Report Letter No. 22, Oct. 4, 1968.

From the standpoint of implementing these regulations, the problems confronting the Office of Foreign Direct Investment and those facing the United States businessman who was required "to learn to live with them" have been formidable. William Chartener, in addressing the 1968 Meeting of the Business Council on October 18, 1968, stated:

> To be sure, there have been some major problems in setting up and administering the program. From OFDI's standpoint these would include:
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> — Changing from a voluntary program to one of mandatory legal restraint;
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> — Operating under a concept that provides different treatment for three different categories of countries;
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> — Writing regulations to cover a great variety of direct investors with respect to both size and type;
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> — Formulating policy for industries with peculiar problems — such as oil and other minerals, construction, shipping, and airlines; and
>
> — Trying to adjust the program as to achieve the target and at the same time permit companies to fulfill prior committments.
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> From the companies' standpoint, the primary problems have been:
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> — Lack of time to adjust to a new program;
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> — Shifting from domestic to foreign financing;
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> — Operating under a base period allowable which leaves little leeway for those who had no investments in 1965 or 1966;
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> — The handicap assumed by companies that held down their investment activities or borrowed heavily abroad under the voluntary program in 1965 and 1966 relative to the position of competitors who may not have followed the same patriotic instinct;
>
> — The strict repatriation requirements in Schedule C countries; and
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> — Adjusting to admittedly complicated regulations.[15]

The general tenor of Mr. Chartener's address was one of assurance that the controls would be temporary, although their termination does not seem likely in 1969, but that business should steer itself in the national interest for continued compliance in the foreseeable future. Whatever the final outcome, it is certain that United States business must continue to plan investment decisions around the regulations. They can, it seems, expect to find the government willing whenever possible to make the task easier for them. Nonetheless, the question of the total effectiveness of controls remains unanswered, as does the more fundamental question as to whether investment controls are even a sensible approach to the economic problems faced by the United States. Critics of investment curbs generally denounce them on the basis that: (1) the position of the United States relative to the rest of world requires ever greater participation by United States private interests abroad; (2) balance-

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[15] CCH Bal. of Pay. Rep., ¶ 9079.

of-payment deficits are only minimally comprised of direct foreign investments that the problem lies elsewhere; (3) present research indicates that pay-back in balance-of-payments terms are too long-range (6½ years for manufacturing investments in Europe) to have any immediate corrective influence; (4) restrictions on business investment could dangerously slow down the domestic economy by precluding local industries who face a saturated domestic market from seeking new foreign markets, except through export, which may not be feasible or economical; and (5) investment curbs can result in economic starvation or malnutrition of existing direct foreign investments by not permitting sufficient flexibility to the direct foreign investor or by virtually coercing him to seek investment in, from his standpoint, a less favorable country.

Putting aside the major lines of dissent to investment curbs for a moment, let us review certain basic facts over the past year in the attempt to see if the payments deficit is actually the result of uncontrolled and excessive foreign investment, and, if possible, to determine the road ahead. Bear in mind the suggestion made previously that direct foreign investments are but a part, and small at that, of a total economic picture. There are numerous variables waiting in the wings to exercise their influence. As the following enumeration presents a potpourri of events since March, 1968, it is difficult to place them in orderly categories for ease of determining (1) their relationship, if any, to deficits resulting from foreign direct investment; and (2) their greater or lesser, as the case may be, influence upon the total balance-of-payments problem. Therefore, the listener (reader) must, to an extent, make his own evaluation of their role.

March, 1968 saw the enactment of a two-tier price system for gold; the removal of the 25% Gold Cover by the United States; and completion by the United States of its Gold Pool Settlements and replenishment of working balances for the Exchange Stabilization Fund; a 25% cut in overseas travel for members of the United States defense establishment; as well as familiarization tours of the United States by foreign travel agents to promote foreign travel to the United States, sponsored by the United States Department of Commerce.

During April moves to increase outstanding loans by the Export-Import Bank from $9 billion to $13.5 billion were made. April also saw the Securities and Exchange Commission adoption of the rule exempting foreign financial subsidiaries of United States-based international corporations from the usual registration requirements of the *Investment Company Act of 1940*. Foreign tourists were provided with a discount card allowing discounts of up to 50% on fares and lodging. The end of the month witnessed the increase of the discount rate by the Federal Reserve system to 5½%.

May brought the announcement that American troop strength in Germany was to be reduced by some 33,000 plus some 13,000 dependents. Civilian employees (5,500), mostly foreign nationals, were removed from the defense department payroll in Germany. Canada moved in the direction of even greater cooperation with the United States with the issuance by the Canadian Ministry of Finance of guidelines to be used by Canadian banks to insure against frustation of the United States payments program by using such banks as part of a "pass through" arrangement. Meanwhile in Washington the Administration pressed for Special Drawing Rights, and by early June had adopted "Paper Gold" officially. June also saw $52 million worth of commodity procurements purchased outside the United States and the monetary reserves of the major industrial countries down about $2 billion in the first quarter of 1968. It was made public that the balance-of-payments were in deficit for the first quarter of 1968 by about $600 million and that peace in Vietnam would only reduce the deficit by $1.5 billion, according to the Assistant Secretary of the Treasury. Attempts to block further drains on our gold reserves received a setback with the disclosure that gold sales for the first quarter of 1968 exceeded $1 billion. Meanwhile, Administration pressure for imposition of a travel expenditures tax was renewed.

While in July, 1968 a lower trade surplus was forecast, Kennedy Round cuts commenced, interest equalization tax collections were up, Canada narrowed its payments deficit and removed the ban on "swapped deposits" imposed in March to defend the value of its dollar, and it was announced that for the second time this year United States imports exceed exports.

By August a lower trade surplus was forecast. The United States Travel Service Program showed an increase of 16.4% in foreign visitors to the United States. The defense department cut back on foreign research spending, and the first evaluation of the OFDI program was announced. This status report did little but to indicate that firms were complying — over three thousand firms had filed FDI-101's, the basic reporting form, and that 950 applications for specific authorizations had been received, of which 800 had been acted upon, contributing $1.5 billion of investment outflow. While the Department of Commerce was announcing a second quarter deficit of some $150 million, the Treasury Department was stating that the United States was making substantial improvement toward achieving equilibrium.

By September, foreign borrowings by direct investors were up but largely unspent, our trade surplus was deteriorating and tourist travel abroad was still large. Internal Revenue proposed a scheme for withholding on the Interest Equalization Tax. It was announced that OFDI controls will likely remain in effect, though prudent individuals rarely thought otherwise, and several compliance actions were contemplated.

October started rather bleakly and few events of that month were viewed as signs of early elimination of the controls or any really effective improvement of the payments problem. A certain air of desperation could be gleaned from the announcements that two new General Bulletins were issued by OFDI as interpretative guidelines and that additional restraints might be required over the short-term, but for long-range improvement, a five-point program for trade improvement was released by the United States Department of Commerce. It was designed to reduce domestic economic growth to or below $15 billion a quarter; make the economy more efficient by emphasizing productivity, apart from a slight anti-labor union coloration to this item; how it was to be accomplished was not detailed — apparently, by exhorting the American businessman and labor with the "Quotations of Chairmen Chartener and Fiero"; a continued effort to reduce foreign barriers to United States exports; admonishments against Congressional attempts to pass protectionistic legislation, though conceding that in certain isolated cases (not specified) they may be appropriate; and finally, an aggressive export promotion program. On the credit side, foreign capital inflows continued high. Under Secretary of the Treasury, Joseph Barr, attributes this promising development to five factors: (1) the United States is one of the few physically secure places in the world, which suggests that these investments may just as well represent "fright capital" inflows as evidence of foreign confidence in the American dollar or international goodwill; (2) that the countries of North America live in peace and understanding with each other, although investment in other highly industrialized nations, *i.e.*, Japan, has certainly shown little evidence of slackening; (3) the American democratic institutions seem viable and strong; this basis for the encouraging increase in foreign investment in the United States hardly seems much in point; (4) only in the United States has the investment market the breadth and depth to permit foreign capital to take a position and to liquidate the same without seriously affecting the price level; and (5) congressional passage of the 10% surcharge on personal incomes, but this has not had the real effect hoped. Since the beginning of this month and running back to the last week of October, the Department of Commerce has been warning, regarding hopes of removal of investment controls in light of somewhat improved conditions, that "We do not want to be misled by our own predictions. There will be little change in 1968, and 1969 will depend upon the situation as it develops during the year." However, this week some easing of the controls was foreseen in the announced liberalization accomplished by allowing a direct foreign investor to select an optional investment quota, which will be equal to 20% of the earnings of a company's AFN's in each of the Schedule areas. This presents an alternative to the current base year guidelines and permits more flexibility to a small or medium-size company with little prior foreign direct investment experience.

A loosening of control slightly in one area is a far step from removal of the curbs, and caution is urged. Since most of this caution emanates from sources within the current Administration, they are perhaps designed to cause the President-elect to go slowly on his on-again, off-again promise to remove the curbs at once. The results of such could cause a $6 million deficit in the balance-of-payments almost immediately if American business rushed to pay off foreign borrowing with money from United States banks to avoid the higher foreign interest rates. It is also doubtful if investment curbs could be removed without an attendant slowdown of the domestic economy, which, even if possible, would surely result in a much higher unemployment rate. This is not desirable in light of the serious domestic problems facing the United States, which only greater expenditures of domestic capital can begin to solve.

On the first anniversary of the devaluation of the British pound, the event was marked by vigorous attacks on the French franc, the West German mark and to a lesser extent the pound, 1968 saw devaluations of a number of currencies and threatened devaluations of others. It has been a period of sustained monetary crisis, which has contributed to worldwide balance-of-payments problems or trade imbalances. It is clear that devaluation of the British pound has not had the expected effect of improving the British economy — it did, however, set off an unprecedented spree of consumer buying, and now almost a year to the day, the British government is considering further tightening of their domestic economy. The United States is far from correcting its now chronic deficits, and American business is becoming restive and eager to cast investment controls to the wind. A change of Administration promises a less "heavy hand" of government upon the private sector, but the distinctions between the public and private sector in the international area are so blurred as to be lost. No one knows which direction to take. Economic advisors of the new Administration voice the hoary dictums of proponents of an earlier era, but the popularity of Keynes is far from exhausting itself.

In the final analysis, as Assistant Secretary of Commerce Chartener has pointed out, the important unanswered questions facing the United States as it embarks upon its second year of "learning to live with Foreign Direct Investment Controls" and its first year of a new Administration are:

> Whether it is in our national interest, as distinct from the individual corporation's interest, that we should encourage the rapid transfer of our new technology and managerial skill abroad, especially to economies that enjoy a considerable advantage in labor costs; and whether the United States is going to be able to maintain open access to our markets for imports, many of them from United States controlled sources.[16]

The final problem I should like to leave you with, and the one currently being studied and discussed in the United States Treasury Department, is what should be done to aid American business in light of the tax harmonization to be achieved by the member states of the European Economic Community on January 1, 1970. European border taxes and its most modern manifestation, the added-value tax, places the American exporter in an uncompetitive position, since direct taxes, rather than indirect ones, are the largest sources of revenue in this country, and a system of rebates for American exporters would have to be developed. Such moves, of course, bring in questions of violations of *GATT*, which would prohibit rebate of direct taxes as an aid to exports. Already, a Working Party on Border Tax Adjustments within *GATT* has started work on this problem in an attempt to arrive at some solution which will not see United States trade balances with the EEC become unfavorable when tax harmonization is achieved. Several suggested policy changes have been proposed which envisaged negotiated changes of *GATT* rules to justify border tax adjustments for indirect taxes only; or changing *GATT* rules so as to permit border tax adjustments for direct taxes. Other proposed changes suggest American adoption of turnover taxes and retreat from our current heavy reliance upon direct taxes. The mildest proposal is for the United States to rebate various indirect taxes not presently rebated.[17]

Taxes are now added as yet another variable in the increasingly complicated balance-of-payments picture. The circle is now complete — we began with money; we end with money.

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[16] CCH Bal. of Pay. Rep., ¶ 9080.

[17] See, "Tax Harmonization in Europe and U.S. Business," *Tax Foundation, Inc. Research Pub.* 16, at p. 22 (1968).