

will reduce the ability of this key sector to help in offsetting the large government sector payments deficits which have trended strongly upward and, on the basis of the historic record, can be expected to continue in that direction.

By way of illustration we will consider the new controls on foreign investments. We recognize, of course, that conclusions drawn from a partial analysis of the balance-of-payments accounts must necessarily be qualified because of the interdependence of the various sectors. For example, restrictions on the outflows of direct private investment capital tend to lower interest rates in this country by increasing the supply of domestic funds, thereby discouraging the inflow of foreign capital. Similarly, to take another example, a cutback in government aid programs overseas tends to depress exports to the extent that they are tied to the purchase of U.S. goods. (Indeed, we feel that the President's objective of an overall improvement of \$3 billion in our payments balance as a result of the new program is far too optimistic because it is based on this sector by sector approach.) Nonetheless, despite the limitations of a partial analysis, it should give some indication of the self-defeating aspects of the proposed controls insofar as the direct investment sector is concerned.

We will further confine our attention to controls on European investments since this has been the area of greatest investment activity in recent years and is now subject to the most rigid controls. We pose the question, "What would have been the result had the controls instituted on January 1 of this year been introduced on January 1, 1959, following the large balance-of-payments deficit in the preceding year?" (These controls prohibit capital flows to direct investment in most European countries, excluding the United Kingdom and certain less advanced countries, and permit reinvestment of earnings in an amount no more than 35 percent of average annual investments in Europe during 1965-66. The remainder must be remitted to this country.) The consequences of introducing this program 9 years ago, when the United States' balance of payments was first recognized to be a problem, would have been roughly as follows.³

Adverse impact on balance of payments.—The book value of direct investments in Europe (excluding the United Kingdom) would have been in the neighborhood of \$4.0 billion at year-end 1966 instead of \$10.5 billion. Earnings from such investments would have been about \$517 million in 1967 instead of actual earnings in the neighborhood of \$750 million. Remittances would have totaled \$233 million in 1967 instead of roughly \$473 million. Exports to European affiliates of U.S. companies would have totaled some \$417 million instead of roughly \$1.1 billion. (We have excluded from both export estimates, those which could have been expected to take place in the absence of U.S. affiliates.)⁴ Management fees and royalties from U.S. investments in Europe (excluding the United Kingdom) would have been roughly \$119 million instead of \$297 million.

In 1967 the dollar inflow from these three factors combined—i.e., remitted earnings, royalties and management fees, and exports would have been in the neighborhood of \$769 million instead of some \$1878 million. Assuming actual outflows in 1967 of \$1129 million to Europe (excluding the United Kingdom) the balance-of-payments effects would have been only slightly more favorable if the ban on capital outflows (inflows totaling \$769 million) had been instituted in 1959 than they actually were in the absence of controls (i.e., \$1878 million income less \$1129 million outflows for a favorable balance of \$749 million).⁵

³ It should be stressed that these figures represent only the roughest of approximations. Again, our purpose is only to give some general notion of the magnitudes involved. Assumptions underlying these computations are described in the Appendix. Results are shown in the tables attached to the Appendix.

⁴ We should not in this connection that, given the nature of the export impact, even the immediate effect of the ban on capital outflows is vitiated to a marked degree by a significant reduction in the exports that otherwise would have taken place. This is because a significant portion of U.S. capital invested in U.S. affiliates abroad has been in the form of capital equipment for installation in new, expanded, or modernized facilities and there has also been a substantial export of materials, parts, and components for further processing or assembly in U.S. facilities in Europe.

⁵ Less onerous restrictions have been applied to investments in other developed countries including the United Kingdom, Canada, Australia, Japan and the oil-producing countries of the Middle East. The adverse impact would have been correspondingly less than that for investments in continental Europe. For example, rough estimates suggest that if these controls had been instituted on January 1, 1959, the value of direct U.S. private investments in these countries at year-end 1966 would have been roughly \$21.8 billion instead of an actual value of some \$26.8 billion. It appears on the basis of historical data that the restrictions on investments in countries other than those comprising these two groups would have a minimum impact on the investments of a majority of companies.