

It is true, of course, that our international reserve position would have been somewhat improved inasmuch as the net impact of the controls would have been favorable in the earlier years. Indeed, although the favorable differential diminishes under our hypothetical illustration during the period under review,⁶ it persists through 1967. Nonetheless, our present posture would have been far worse. Our cumulative deficit on direct investment account (in the absence of offsetting reactions in other sectors) would have been reduced by about \$3.1 billion from the end of 1958 through the third quarter of last year (from \$22.2 billion to \$19.1 billion). The nature of the deterioration in our international reserve position since year-end 1958 suggests that some 36 cents out of every dollar accumulated abroad was converted into gold (with much of the remainder held in the form of dollars and short-term dollar claims).⁷ On this basis we may speculate that our gold holdings would have been about \$1.1 billion greater and our short-term liabilities about \$2.0 billion less at the end of last year's third quarter than they actually were. Our gold holdings would have declined from \$22.5 billion to \$16.0 billion (instead of to \$14.9 billion) and our short-term liabilities would have grown from \$15.4 billion to \$26.8 billion (instead of to \$28.8 billion).

This difference of \$3.1 billion out of a cumulative deficit of \$22.2 billion would hardly have been sufficient to set at ease the world's concern about the U.S. position in view of our immense international commitments and the direction which we have been moving. Further, this favorable cumulative differential would have been increasingly dissipated as the favorable annual differential turned adverse. The favorable annual differential would have virtually disappeared in 1967, and almost surely would have turned adverse this year based on our illustration. And, of course, if such rigid controls over direct investment had already been instituted along the lines of our assumption, the government would have been unable to fall back on such controls (voluntary or otherwise, permanent or temporary) in an attempt to alleviate the situation which we face today.

One final point should be made concerning our hypothetical illustration. It might be argued that, being unable to use U.S. capital for accomplishing their investment objectives in Europe, U.S. companies and their affiliates would have borrowed abroad to this end with favorable effects for the U.S. balance of payments. Such borrowing would *not* have been reflected in increased book values of U.S. investments, inasmuch as the Commerce Department treats foreign loans as liabilities to foreigners rather than U.S. companies. However, it might have served to increase earnings to book value ratios to the extent that the added earnings attributable to the use of the borrowed funds exceeded interest costs and it might also have raised somewhat the ratio between U.S. exports to European affiliates and the value of their investments in those affiliates, insofar as the borrowed funds facilitated increased purchases from the U.S. On the other hand, some companies presumably would have been unwilling to borrow abroad, more would have at least reduced their commitments, and companies without established reputations or contacts abroad would simply have been unable to gain access to foreign capital. Indeed, given the limited development of capital markets in Europe and elsewhere, capital would not have been available on anywhere near the scale needed to replace U.S. sources and the borrowing costs would, of course, have been increased, perhaps sharply. Finally, we feel that we have, in any case, been very conservative in our estimates to the point where we have tended to understate the adverse effects that could have resulted from the controls. In short, we do not consider that including the effects of foreign borrowing in our illustration would have significantly modified the conclusions.

⁶ This favorable differential is, of course, less than the difference between the actual value of investments at the end of a given year and what that value would have been under the controls. That is to say, the reduced level of investment values resulting from the controls is by no means a measure of the improvement in the payments balance that we might have expected as a result of their imposition. The reduced investment resulting from an elimination of capital outflows brings in its wake a comparable reduction in earnings and a corresponding reduction in funds available for reinvestment (and for remittance to the U.S.) leading in turn to a further reduction in investments greater than the reduction in capital outflows resulting from the controls. This adverse effect is cumulative, of course, as the divergence between actual foreign earnings and those which would have occurred in the absence of controls becomes ever wider. Eventually, the adverse effects from the reduction of earnings from which remittances (and reinvestments) can be made more than offsets the favorable effects resulting from the prohibition of outflows and the controls thereby prove ultimately to be self-defeating.

⁷ See Appendix for explanation.