

Controls

This voluntary program is now substituted by a mandatory one, despite admitted "excellent business cooperation" with the former. Besides the stated necessity to curtail outflows, a justification for the new controls is "to insure equality of burdens among all direct investors." Such an objective is hardly accomplishable. Not only have inequities already been built in, but the history of foreign investment precludes equal treatment now. Inequities have been built in by assuming a given base period as appropriate—one under which voluntary controls existed. But, some companies tried to do more than their share and even paid out dividends greater than earnings, taking funds from surplus, and making no new investment. Their base is thereby restricted to zero and 65% of zero is still zero. A company which delayed investment, as requested, in 1965-67, also reduced its base; only those that invested to the limit are not discriminated against.

Companies that were projecting their first foreign investment abroad have no base at all, while companies having invested over 20 or more years have long since stopped sending dollars overseas and need no base; having established a policy of returning 60 to 65% of earnings anyway and borrowing locally as needed, the 35% limitation on the "moratorium" countries is no constraint. Nor can the medium and small-size businesses borrow readily abroad to make their investment. Thus, there is discrimination based on who was abroad first and how long. And exceptions granted by Commerce merely intensify the possibility of inequities, for administrative judgments are seldom equal nor circumstances similar.

The effect of controls whether under the voluntary or mandatory system is always discriminatory; it is impossible to determine whether situations are equal or to treat the new-entrant equitably. Further, what is equitable among companies may not be the best policy for the economy, if it *must* reduce outflow and increase inflow. Such an objective would argue for a careful selection of projects to be approved which would require the least outflow and provide the largest and most prompt return to the U.S. of funds. The discrimination which will result from present procedures will produce a warping of the foreign investment flows and future returns which will certainly be different from that without controls, but with what precise damage we cannot now tell.

Both government and business officials have said since 1965 that the controls should not be continued for long and that the damage to company operations and the U.S. balance of payments would be large if restraints remained. We cannot know precisely the impact of the past constraints on the present payments position, but the longer they remain the better we can estimate for the impacts to begin to fit the average pattern of investment flows and returns. Thus, we may use the aggregate statistics to show the effect of continued controls over foreign investment.

As recognized in the Council report, capital outflows account for between 30 and 35% of capital outlays abroad, 20% comes from re-invested earnings, long-term borrowing abroad about 8%, with short-term borrowing and depreciation allowances constituting the remainder. Thus, on the average and including expansions of existing plant and new enterprises, expenditures for plant and equipment abroad of \$1 million require no more than \$350,000 of outflow. This outflow is immediately reduced by sales of capital equipment and patents owned by the parent, as well as technical assistance, to the affiliate. These will amount on the average to \$50,000 each—often higher for countries outside of Europe. Thus, the net outflow will be on the order of \$250,000. Exports may have been stimulated by realization in the market that a local supply would soon be available, but some exports may also be substituted by foreign production. Apart from these shifts, the affiliate will soon return income from earnings and sometimes management and R&D fees.

The accompanying table illustrates data from different investment situations. The first, relying on the aggregate data on manufacturing investment abroad, demonstrates that the payback period for outflows of U.S. dollars is about 2½ years—on the average. But this average is made up of different projects—some returning funds immediately to the U.S. and without any outflow and others draining dollars for several years before they are offset by earnings and exports through the affiliate. The extreme unfavorable situation is that of a company making a mis-calculation as to whether its exports would decline and investing abroad when it did not have to in order to maintain its market. It is unlikely that it would ever repay the lost exports.