but the size of the difference is diminishing as outflows are beginning to decline and remittances are continuing to show substantial increases. Further, this difference is highly misleading because dollar inflows generated by investment in Europe exceed dollar outflows into such investments by a substantial volume when one takes account of the export impact of such investments and of royalties and management fees deriving from these investments.

For example, we estimate that U.S. exports to European affiliates of U.S. companies exceeded $1.5 billion last year and this estimate excludes exports that would have occurred in the absence of these affiliates.[1] This itself is far greater than the adverse differential between remittances from and outflows to direct U.S. investments in Europe last year. Further, there is the added income in the form of royalties and management fees from direct European investments which were at an annual rate of some $450 million in the first three quarters of last year. Hence, it is clear that the positive contribution to the balance of payments deriving from direct European investments is very large indeed.

A Strong Adverse Impact Can Be Expected From Controls on Direct Investment

It is perfectly apparent that a flat prohibition on capital outflows to Europe will have an immediate favorable impact on the U.S. balance of payments by eliminating outflows while inflows continue. This favorable impact must be discounted even in the short run because of detrimental effects on exports which will flow from the control program. Moreover, given the long-term nature of our balance-of-payments problem and the unfortunate fact that payments controls, once established, often take on a permanent aspect, the ultimate effects of the mandatory controls on direct investment can be highly detrimental. For they 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 taken 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.

[1] We developed a rough estimate of $1.7 billion using U.S. Department of Commerce data. This represents only the roughest of approximations but does give some notion of the order of magnitude of the export impact. Assumptions underlying these estimates and other details concerning their derivation are described in the attached appendix and tables.