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Folder List

<u>Box Number</u>	<u>Folder Number</u>	<u>Document Date</u>	<u>Document Type</u>	<u>Document Description</u>
17	8	12/01/1969	Newspaper	"Imported Shoes Create Problem" in The New York Times. 1 pg. Not scanned.
17	8	05/29/1968	Newspaper	"Income and Spending Part III" in The Journal of Commerce. 1 pg. Not scanned.
17	8	05/28/1968	Newspaper	"Income and Spending Part II" in The Journal of Commerce. 1 pg. Not scanned.
17	8	05/28/1968	Newspaper	"Five Year Trade Bill Is Sent to Congress" by Richard Lawrence in the Journal of Commerce. 2 pgs. Not scanned.
17	8	06/26/1968	Newspaper	"Travel Industry Upset by New Try by Administration for Tourist Tax" in the Journal of Commerce. 1 pg. Not scanned.
17	8	06/1966	Newsletter	Republican Coordinating Committee Housing and Urban Development Task Force on the Functions of Federal, State and Local Governments. 12 pgs. Only cover scanned.

<u>Box Number</u>	<u>Folder Number</u>	<u>Document Date</u>	<u>Document Type</u>	<u>Document Description</u>
17	8	06/25/1968	Report	Statement by Henry Fowler, Secretary of the Treasury before the Senate Finance Committee on H.R. 16241. 49 pgs.
17	8	06/1968	Report	Technical explanation of the foreign travel tax and technical explanation of the proposed changes in customs rules relating to tourist exemptions. 25 pgs. Attached to previous.
17	8	06/17/1968	Report	Remarks by Frederick Deming, Under Secretary for Monetary Affairs, Department of the Treasury, at the 6th international program of the Instituto de Estudios Superiores de la Empresa. 15 pgs.
17	8	06/13/1968	Newspaper	"US Foreign Trade Commission Urged" by Richard Lawrence in the Journal of Commerce. 2 pgs. Not scanned.
17	8	06/06/1968	Report	The Impact of US Controls on Foreign Investment in the Congressional Record-Extensions of Remarks. 3 pgs.
17	8	n.d.	Book	Tax Policy Research Study Number One: Overseas Manufacturing Investment and the Balance of Payments by G.C. Hufbauer (Univ. of NM) and F.M. Adler (Univ. of Penn). US Treasury Department. 92 pgs. Only cover scanned.



HOUSING AND URBAN DEVELOPMENT

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Prepared under the direction of the
Republican National Committee
1625 Eye Street, N.W.
Washington, D.C. 20006

STATEMENT BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
BEFORE THE
SENATE FINANCE COMMITTEE
ON
H. R. 16241
TUESDAY, JUNE 25, 1968, 10:00 A.M.

Boj Payments

Thank you for giving me the opportunity to discuss with you

H. R. 16241, a bill containing a portion of the Administration's
recommendations for dealing with our foreign travel payments deficit.

These recommendations are a part of the overall program set forth
by the President in his January 1st Message on balance of payments.

Before discussing the details of this legislation and our recom-
mendations in this area, let me place this measure in perspective
by reviewing with you our overall balance of payments program and
how it is progressing.

I. The Balance of Payments Program.

I think it unnecessary to detail the conditions which led to
the President's balance of payments message. You are all familiar,
I am sure, with the fact that our balance of payments deficit for the

year 1967 was almost \$3.6 billion, and in the final quarter of the year exceeded \$1.8 billion, which would represent a deficit of over \$7 billion on an annual basis. These deficits, together with the devaluation and difficulties of the British pound, the other reserve currency, have led to intense gold speculation and doubt about the survival of the international monetary system as we know it.

On January 1st, President Johnson set forth an Action Program to deal with our balance of payments problem, as a national and international responsibility of the highest priority. This program stressed, as the first order of business, the urgent need for enactment of a tax surcharge which, coupled with expenditure controls, would help to stem the inflationary pressures threatening both our economic prosperity and our trade surplus. This fiscal package, now happily becoming law this week, is the keystone of our program to correct the balance of payments problem.

In any discussions of the balance of payments problem, we cannot overlook the other features of the President's "first line of defense of the dollar." It is of unquestioned importance that business and labor work together to make effective the voluntary program of wage-price restraint and to prevent work stoppages that will adversely affect our foreign trade.

In addition, the President's program called for a number of both temporary and long-range measures directed at the improvement of specific sectors of our international payments accounts.

These specific measures included a five-part program designed to achieve near equilibrium in our balance of payments deficit this year by calling upon each major segment of our economy importantly involved in the balance of payments to make a contribution to this savings target. This program asked:

-- American business to reduce its outlays for direct investment abroad by \$1 billion, under a new mandatory program to be administered by the Commerce Department;

-- Banks and other financial institutions to reduce foreign lending by \$500 million, through a tightening of the voluntary restraint program administered by the Federal Reserve Board;

-- The American people to reduce their overseas travel expenditures by \$500 million, on the basis of the President's request for voluntary deferral of nonessential travel plus legislation to help achieve a reduction in travel expenditures by those who do travel;

-- Government to reduce or offset its expenditures overseas by \$500 million, through specific action programs assigned to the Secretaries of State, Treasury, and Defense and the Director of the Budget; and

-- For prompt cooperative action through consultations with our trading partners to minimize disadvantages to our trade, or appropriate legislative measures, to realize a \$500 million improvement in our trade surplus.

It is the travel portion of this immediate direct action program which at this time requires legislation. In the other sectors, the measures called for have been instituted and are underway.

Thus, for business, the mandatory restraints on direct investment have been in operation under Commerce Department regulations since January 1st and have, during the first quarter of 1968, already had a sizeable favorable impact on our balance of payments.

For banking, the Federal Reserve Board restraints on foreign lending were, similarly, issued and effective on January 1st. Major progress has already been made toward achievement of the goal under this program, with a decline of about \$350 million (seasonally adjusted) during the first quarter of this year in commercial bank claims on foreigners.

The government has taken action on each of the three specific steps to reduce expenditures abroad listed by the President in his January 1st Message:

-- Discussions with a number of countries in both Europe and Asia to find various ways to reduce the foreign exchange costs of maintaining our troops abroad are already well underway.

-- An initial program for a 12 percent reduction of overseas staffs by the end of 1969, together with a further tightening of Government travel abroad, was put into effect on March 30; and a second-stage effort to achieve even further reductions, primarily in the larger overseas missions, is underway.

-- The Department of Defense is examining a series of possible specific measures to reduce further the foreign exchange impact of personal spending by U.S. military personnel and their dependents in Europe, which are importantly related to civilian tourist travel.

In addition, the President, on January 11, directed AID to reduce overseas expenditures in 1968 by a minimum of \$100 million below the 1967 level.

For trade, the President's Special Trade Representative, Ambassador Roth, has headed an effort by many of our overseas missions to explore actively with our major trading partners possible immediate as well as longer-term cooperative actions to contribute toward improvement in our trade surplus. Ambassador Roth has reported on these discussions in the current hearings before the House Ways and Means Committee.

A Working Party in the GATT has been instituted at U.S. initiative and is now engaged in an examination of existing provisions dealing with border-tax adjustments and their effects on trade, looking to the development of a program designed to remove or minimize any significant disadvantage to U.S. trade that results from the existing GATT provisions and the tax systems of our principal trading partners.

In other words, action on each of these parts of the President's balance of payments program is well underway. The one remaining

aspect of the program is the travel area where the goal is to reduce the balance of payments deficit by \$500 million. H. R. 16241 represents a beginning -- modest as it may be -- of the action required to effect an immediate reduction in the outflow of dollars. A long-range program of a different direction, to increase foreign travel to the U.S., is already well underway, having as its cornerstone the recommendations of a Task Force headed by Ambassador McKinney. I should like to file a copy of the Report of that Task Force which undertook this work early this year and submitted its report to the President on February 15, 1968.

II. The Continuing Need for a Full Implementation
of the January 1 Program.

Events since the beginning of the year have confirmed that the President's full Action Program is needed to help bring our balance of payments to equilibrium, to maintain confidence in the dollar, and to stabilize the international monetary system.

Our balance of payments deficit, sorely affected by the fall-off in our trade surplus, ran at too high a rate in the first quarter.

The first-quarter results released on May 14 show a liquidity deficit of \$600 million, seasonally adjusted, equivalent to an annual rate of \$2.4 billion.

This does show, I am happy to say, a quick and quite substantial recovery from the extremely high and totally unsustainable rate of deficit which we suffered in the last three months of last year.

However, continued effort is necessary to advance us further toward our vital goal of sustainable equilibrium. Although we made notable gains in the first quarter, these were mainly due to a number of factors in our capital accounts. These included:

(1) A sharp reduction in bank lending and large sales of special corporate bonds to foreigners, in connection with the Federal Reserve and Commerce programs;

(2) Foreign net purchases of U.S. corporate stocks which amounted to about \$275 million, approximately maintaining the

same post-war record rate averaged during the last half of 1967; and

(3) One large known transaction, classified as foreign direct investment in the United States, involving an inflow of slightly over \$200 million.

We certainly cannot rely only on ~~improvement~~ in the capital accounts to restore equilibrium in our balance of payments -- we must look to the achievement and maintenance of a substantial merchandise trade surplus as an essential cornerstone of our balance of payments. However, during March, in particular, and for the first quarter of this year, as a whole, our performance on trade account has been very poor -- reflecting the crucial importance of the tax increase-expenditure reduction measure to curb domestic inflationary pressures and the excessive increase in imports that

characteristically accompanies an excessive rate of growth in our economy. Our trade surplus for the first quarter fell to an annual rate, after seasonal adjustment, of only slightly over \$400 million -- compared with a \$1.3 billion annual rate based on the final quarter of 1967, and a \$4.2 billion annual rate based on the three preceding quarters of last year.

On other fronts also, events during the interim since January 1st, have further underlined the reality of the threat to our dollar which was feared at the beginning of the year. From February 7 to March 20, 1968, we experienced a period of intense speculation in the foreign exchange and gold markets of the world. During this period, the Treasury Department transferred a total of \$1-1/2 billion in gold to the Exchange Stabilization Fund in order to replenish its working balances and complete the settlement of the United States' share of the losses experienced by the gold pool.

These gold losses clearly indicated the concern held by foreigners as to this country's persistent balance of payments deficit. The situation threatened to bring about serious difficulties for the world's entire financial structure, with accelerating interest rates and the choking off of credit availabilities beginning to spread from the international money markets into domestic markets.

The impact of this monetary crisis was felt not only by bankers and finance ministries of the world. The American traveler also was directly affected. For example, over the period of March 14 through March 18, many American travelers experienced considerable difficulty spending or converting their dollars at the hotels, restaurants, and banks of Europe. When they were permitted to convert, it was frequently at a large discount. Thus, some American travelers were getting only --

- 94 cents for a dollar in Paris
- 96 cents for a dollar in Italy
- 80 cents for a dollar in Germany

I would venture to say that these Americans who experienced the direct effect of a lack of confidence in the dollar would welcome, if not insist upon, immediate measures to insure that their dollars are not so threatened again.

Fortunately, as a result of the meeting, on March 16-17, of the gold pool central bank governors in Washington, decisions were made and action was taken to restore order to the financial markets. However, the cost of those six weeks of speculative activity in terms of our loss of gold and in terms of the strain on the international monetary system was severe. The steps that have been taken -- while representing an effective solution for the immediate problem -- will not guarantee against a repeat performance in the future. We can only protect against further attacks on the dollar -- and, through it, the world monetary system -- by striking at the root of the problem -- the persistent imbalance in world payments, with a deficit in the United States and a surplus in Europe.

III. Foreign Travel and the U. S. Balance of Payments.

Foreign travel expenditures are a major contributor to the balance of payments deficit and a comprehensive program to close the deficit would be incomplete and out of balance were travel omitted.

In 1967 alone, a record number of Americans traveling outside the United States spent \$4-3/4 billion, an increase of 17 percent over the previous year. These expenditures involved a foreign exchange cost of \$4 billion. Receipts from foreign visitors to the U. S. came to only \$1.9 billion leaving a deficit of about \$2.1 billion.

In fact, for the period 1961 through 1967, the total foreign payments for international travel (about \$21 billion) were nearly as great as the total foreign exchange costs (\$22.9 billion) of our military expenditures abroad, including the foreign exchange costs of the war in Southeast Asia. In other words, the balance of payments costs of our foreign travel have been equivalent to the balance of payments costs of our national security to the extent it depends upon the operations or presence of our military forces outside the United States.

We hear a great deal in some quarters about ending the war in Southeast Asia or bringing United States military forces home as a means of reducing our balance of payments deficit. We also hear a great deal about reducing our forces in Western Europe because of their foreign exchange costs. I am not here today to debate these issues. I am here to say that the government which adopts a program of doing whatever it can, consistent with national security, to reduce or neutralize the foreign exchange costs of our military operations overseas, must similarly tackle the problem of travel expenditures when our balance of payments is still in a serious state of chronic deficit.

The net foreign exchange impact of this level of foreign travel spending can be measured by offsetting against it the spending in the U. S. by foreign travelers. For the same 1961 through 1967 period, the net deficit in foreign exchange payments arising from tourism amounted to a little over \$11 billion, as compared to about

\$17.4 billion net foreign exchange deficit for military expenditures abroad after offsetting the foreign purchases of military equipment in the U.S. Moreover, unless effective measures are undertaken, the situation with regard to travel can only get worse in the future.

In this regard, the Chase Manhattan Bank recently published in its June, 1968, "Business in Brief" a summary review of how travel figures in the United States Balance of Payments. This summary states, "Travel is a fast growing element in United States international financial accounts. Outlays far exceed receipts, helping to create payments deficits." The bank points out that foreign travel is among the major causes of dollar outflows; the \$4 billion of foreign travel payments in 1967, being almost as large as military spending of \$4.3 billion.

The bank presentation also calls attention to the fact that expenditures abroad by Americans and expenditures in the United States by foreigners have both been increasing, and indeed the latter rate of increase on a much smaller base has been somewhat greater.

The important point clearly indicated by these figures however is that "if recent rates of growth in travel persist, the dollar gap between outlays and receipts will continue to widen." Thus the bank summary shows that under a continuation of growth patterns that have been exhibited in the past few years, the \$2 billion of deficit in 1967 will widen to \$3 billion by 1975. Other estimates, taking into account the greatly increased travel which will flow from the new high passenger "air-busses," place the travel deficit in 1975 at much higher figures.

All of the economic and social forces at play within our economy will inevitably lead to more Americans traveling abroad in the future and spending more. First, it is anticipated that disposable income will increase year by year. Thus, even if the percentage of disposable income which is spent on foreign travel remains constant, the year-by-year increase in disposable income will automatically lead to a year-by-year increase in amounts spent on foreign travel.

In fact, however, it is reasonable to expect that the percentage of disposable income spent on foreign travel will also increase, thereby further increasing the foreign travel payments.

One factor which leads to this conclusion is the rising level of education in this country which should lead to more and more people wanting to travel to foreign countries for its educational value.

Second, as per capita income rises, a larger percentage is available for less-essential spending which would undoubtedly include travel.

Furthermore, the anticipated introduction of airplanes with much larger capacities brings the prospect of lower air fares which should encourage more people to travel abroad.

In other words, the economic and social trends in this country can lead to no other conclusion than that our foreign travel payments will increase year by year. This situation, present and future, presents a problem that cannot be dismissed or laughed off or put under the rug.

The long-term solution to moderating our travel deficit lies in a strong program to encourage travel by foreigners to the United States. A Task Force under Ambassador McKinney has examined ways to achieve this goal and has made a series of recommendations, some of which are already in effect. This represents a significant step towards a long-term solution.

It cannot be expected, however, that travel by foreigners to the United States will serve to moderate sufficiently the projected United States foreign payments abroad, at least over the near future while the recommendations of the Travel Task Force are being put into effect and their results assessed. The major problem is that the present disposable income base from which travel by foreigners can be financed is much smaller than the United States disposable income base from which our foreign travel is financed. Moreover, there are fewer Europeans than Americans with sufficient income to finance travel overseas.

If one looks at the principal travel expenditure potential as located in people with incomes over \$10,000, there are about five times as many of these travel spenders in the U. S. as there are in the principal countries of Western Europe.

Moreover, for 1965, U. S. disposable income was about \$470 billion while the disposable income of the major Western European countries was around \$275 billion. Thus, even though some Europeans may put a heavier emphasis on travel in their budget priorities than do Americans, and even if there were an immediate significant increase in the percentage of disposable income spent by Europeans in travel to the U. S., the absolute dollar gap between their spending in the U. S. and our spending abroad could still grow over the short run. Therefore, remedial measures of a less pleasant and a more restraining nature are necessary.

The travel program which we proposed to the House Ways and Means Committee contained three elements:

1. Permanent elimination of the exemption of international flights from the 5 percent tax on airline tickets.

2. Permanent reductions in the duty-free allowance for articles brought into the United States by returning travelers and for gifts sent by mail.

3. A temporary tax based on expenditures made by travelers abroad.

The bill before you, H. R. 16241, essentially carries out the first two of these recommendations but contains no provisions regarding the third.

Our total travel program was estimated to yield an improvement in our travel deficit of \$500 million. The legislation before you, it is estimated, will improve our balance of payments position by \$140 million, less than a third of the needed \$500 million. As I have already indicated, there has been no lessening in the need for a savings nearer the proposed

\$500 million level. Therefore, I urge your Committee to add to H.R. 16241 a tax, along the general lines we have proposed, to restrain spending in connection with foreign travel.

More specifically, we propose that a progressive tax be imposed on foreign travel expenditures. Under the rate schedule, the first \$15.00 per-day of expenditures (computed on an average basis over the entire trip) would be exempt from tax; the total of expenditures in excess of that basic exemption would be taxed at a 30 percent rate. The tax is structured in this manner in order to achieve the necessary balance of payments effect by encouraging travelers to keep their spending to a modest level rather than to cancel their trips. In this way it offers the greatest opportunity for foreign exchange savings with the minimum interference with travel.

This proposal differs in only one major respect from that which we presented to the Ways and Means Committee. Under our original proposal, only the first \$7.00 of average daily expenditures would have been

completely exempt from tax; the next \$8.00 would have been taxed at a 15 percent rate and the excess at the 30 percent rate. Thus, while practically all travelers would have been subject to at least some tax, it would have been very modest for those who traveled modestly and generally would not have required people to cancel their trips.

Nevertheless, some of those who commented on our original proposal indicated that even a modest tax would force cancellation of some desirable trips, especially those made by students and others on very strict budgets. As revised, our proposal would avoid this possibility in that a student or other traveler could completely avoid the expenditure tax by keeping his average daily expenditures below \$15.00. This level of daily expenditures would seem completely realistic, especially for the type of trips taken by students and others traveling on modest budgets. Moreover, the elimination of one of the tax brackets will simplify the tax computation.

It has been suggested that the per diem exemption be replaced by a flat per-trip or per-year exemption. This alternative presents certain problems. First, it would graduate the degree of spending restraint by the length of the trip, and, by so doing, would favor shorter trips over longer trips. The available statistics show that in income groups below \$20,000 the total expenditures per trip are relatively the same, but the less affluent spend less per day and stay longer. This latter group is heavily weighted with students, teachers, and individuals visiting foreign relatives, all of whom are likely to need extended trips in order to meet their objectives. A per diem exclusion recognizes this trend by allowing a basic exemption based on the number of days of travel. Thus, even those whose travel objectives require a trip of above average length will be able to take the trip at a modest spending level without undue concern for the tax. A flat exemption per trip would, on the other hand, favor those who take shorter trips by allowing them a higher average

per-day rate of expenditures subject to the exemption. This group consists generally of the more affluent, where the so-called big spending is more likely.

Furthermore, if the exemption were on a per-trip basis, it would unfairly favor frequent short trips over a single trip of the same total duration. For example, a person who took four 20-day trips would be entitled to four times the amount of exemption as a person who took one 80-day trip. Again, in this respect, a per-trip exemption would favor the wealthy who are more able to take many trips abroad.

If some provision were added to limit the multiple trip problem, such as no more than one exemption per year, an undesirable degree of rigidity would be interjected into the tax structure. For example, a businessman may honestly believe that he is going to take only one trip during a year and, accordingly, use up his whole exemption on that trip. If a business emergency were to require a second trip, each dollar would be subject to the full 30 percent tax no matter how modest the

spending by the individual. This could result in an unreasonable burden. Thus, we recommend retaining the per-diem approach.

By structuring the tax in the manner we have, there is no necessity for providing a list of exemptions for specific types of travel which might be considered especially important, either from a business or a cultural standpoint. Instead, the traveler can avoid or minimize the impact of the tax by keeping his spending to a modest level. It would seem clear that specific exemptions are undesirable as they require arbitrary distinctions and administrative complexities.

On the other hand, our proposal does draw a distinction between individuals who are traveling and those who have essentially shifted their residence abroad. The tax would not apply to this latter category, which includes businessmen transferred abroad for a substantial period and students and teachers who are either studying or teaching abroad. In these situations, the individual is likely to have substantial expenses in setting up his household with the result that the imposition of a tax

might cause considerable hardship. These exemptions, as well as the other details of our proposal, are explained in the attached technical explanation.

We estimate that the balance of payments savings from this expenditure tax would be about \$115 to \$140 million per year.

This travel tax has been criticized on several different levels and, at the risk of appearing defensive, I would like to catalogue these criticisms and give you the other side. This seems particularly required in view of the general lack of balance in the testimony which has been presented to date.

There are those who argue that there is no balance of payments problem. I have already discussed this in some detail and am sure you are as well aware as I am that this is just not the fact.

In this regard, it has been contended that we have overstated the travel deficit by not including the purchase of airplanes by foreign airlines as an offsetting expenditure in the U. S. First,

certainly not all foreign airplanes are used solely to transport travelers to and from the United States. Second, moving airplane sales from the trade account to the travel account will not alter the overall balance of payments deficit or the fact that Americans spend about \$4 billion each year in connection with foreign travel -- which is almost 10 percent of this country's total foreign payments. Thus, a mere bookkeeping change will not eliminate the immediate need for reducing our foreign travel payments.

It has frequently been stated that the travel tax would interfere with the inalienable right to travel. While the value of travel is unquestionable, the fact nevertheless remains that a family must budget for its travel outlays and so must the nation budget its international expenditures to the foreign exchange available. As I have already indicated, we have structured the travel tax to accomplish this national budgeting with as little interference with travel plans

as possible. The bulk of the foreign exchange savings will come from reduced spending while on a trip, and not through cancellation of the trip.

Other critics claim that an affirmative program restraining our travel expenditures abroad will be ineffective because of the retaliation it will evoke. An area of retaliation frequently pointed to by these critics is a reduction in foreign orders for United States aircraft. Close examination does not lend credence to this fear. The travel program is specifically designed to have the least impact on the number of people traveling abroad. This effect should be even more pronounced with our proposed modification in that there would be no expenditure tax imposed -- and, therefore, no motive to cancel the trip -- where spending is below \$15 per day. The tax should thus have the least effect on the airline business, and therefore on aircraft orders, of any form of restraint on travel expenditures.

The next group of critics focuses directly on the structure of the travel tax and takes the position that it is unworkable, unenforceable, unfair and ill-conceived -- to say the least.

They say that the tax will fall heavily on teachers, students, and other low income people; that it will have little effect on "jet-setters;" that it will involve mountains of red tape; and that it will encourage Prohibition-type evasion.

The proposed tax clearly cannot be faulted on equity grounds. The tax is progressive according to expenditures, which, after all, is the factor contributing to the balance of payments problem.

It is designed so that one traveling modestly will incur little or no tax. On the other hand, the 30 percent rate on expenditures over \$15 per day is a significant continuing deterrent to marginal expenditures even by the most affluent traveler.

A substantial tax on tickets, such as 30 percent, or a tax on each traveler in a fixed amount, or a tax graduated by the number of days of travel would fall equally on the modest traveler and on the lavish traveler. Such taxes would therefore represent a far greater proportion of the expenditures of the less affluent and would be no continuing deterrent to the more affluent. In other words, they would be grossly inequitable.

As to enforcement, just as one can argue that there are ways to evade the travel tax, one can argue that there are ways to evade the income tax -- and some people try it. Out of 100 million returns filed in the United States, however, and out of 3 million returns examined, there were about 1,000 fraud indictments last year. This clearly demonstrates that the great mass of American taxpayers accept their responsibility to pay taxes -- if not happily, at least honestly. There is no reason to believe the travel tax would not be accepted in the same way.

Much of the criticism based on complexity and evasion involves a misconception of the tax. The tax does not involve the itemization of any expenditures. Therefore the picture presented by some critics of European hotel clerks busily grinding out \$3 receipts for \$25 suites would **not** materialize. The tax is based on the difference between the amount of money and traveler's checks a traveler leaves the United States with and the amount left when he returns. This will be the extent of the computation for most travelers. For those who use credit cards and personal checks, these amounts would be added.

But no one need carry pencils and pads -- or take his accountant -- with him on his trip to Europe.

The final level of criticism is that, even accepting the need for a travel tax and the structure of this proposal, it cannot do the job of effecting the anticipated balance of payments savings. These critics point to the fact that the tax is applicable only to travelers outside the Western Hemisphere and, moreover, that large groups of such travelers, such as businessmen, persons visiting relatives in Europe, teachers and students, will travel to Europe despite the tax. They claim that it will have no effect on the wealthy. They therefore contend that the base on which the tax can operate is only vacation travel outside the Western Hemisphere by middle income people and that a base so limited is insufficient to yield the balance of payments savings we are seeking.

This criticism ignores the structure of the tax. The tax indeed assumes that most travelers to Europe will not cancel their trips. On the other hand, it is fair to assume that all types of travelers will respond in some degree to the tax, either

by keeping their spending below the exemption level, by shortening their stay by a few days, or by eliminating some marginal expenses. Indeed, a traveler contemplating spending \$25 a day could absorb the entire tax, including the ticket tax, by cutting only 4 days from a 30-day trip. If the \$25 a day traveler wanted to spend his full 30 days in Europe, he could offset the tax by reducing his expenditures to about \$22 a day. It is therefore reasonable to believe that travelers of all types will examine their spending plans with the tax in mind. On this basis, a \$115 to \$140 million balance of payments savings out of the almost \$1.5 billion in contemplated travel expenditures for travel outside the Western Hemisphere seems clearly attainable.

It is also reasonable to expect that this would be a real savings and not produce just a transfer of the travel to countries in the Western Hemisphere. There may, of course, be a certain number of travelers who will revise their plans. But it is clear that the existing tourist facilities in the Western Hemisphere outside of the United States will not accommodate a large amount of additional tourism.

In other words, the tax is designed to meet equitably the need for temporary restraint on foreign travel spending, with due regard to the varying types of travelers. Its mechanics for the vast majority of travelers are uncomplicated and can be readily understood and satisfied. The tax, thus, offers an essential and feasible bridge to the time when our longer-range programs to increase tourism to the United States take hold.

If no measure is enacted to deal directly with expenditures by U. S. travelers, the overall improvement required in our balance of payments position can be achieved only if other sectors of the economy contribute more than their fair share.

Thus, I consider the foreign travel tax today, as I did on

February 5, as essential part of our balance of payments program.

The confidence of the rest of the world in our dollar depends, in

part, upon the resolve we demonstrate to put our financial house in

order. The bill before you today is a step in the right direction

as well as a solid structural revision in our tax and Customs laws.

But the dramatic demonstration of our resolve and a sizable reduction

in our travel deficit rests upon the absent portion of the Administration's

program -- the foreign travel tax.

III. Substance of H. R. 16241

1. Ticket Tax. Present law imposes a 5 percent tax on the amount paid for an airline ticket purchased in the United States.

International flights are, however, exempt from this tax. This

exemption was enacted in 1947 for the purpose of stimulating overseas travel by Americans and thereby to increase the flow of dollars to Europe. Obviously, this exemption is no longer justified and this bill eliminates it by permanently extending the existing air ticket tax to all amounts paid for air transportation where the tickets are purchased within the United States.

The bill, in addition, eliminates most of the present exemptions from the ticket tax. The basic domestic airline ticket tax is in the nature of a user charge in that the revenues derived from it are considered as payments in return for the activities of the Federal Aviation Administration in providing services principally concerned with air navigation and safety. Viewed this way, exemptions from the tax are unjustified. Therefore, exemptions previously accorded state and local governments, colleges and universities, and U.S. government travelers have been eliminated as a permanent structural improvement in the law. These entities certainly have no less an interest in the safety of their employees who travel by air than do other employers. Equally, they have no less an obligation to help meet the costs of insuring this safety.

The changes made by the bill in the existing air transportation tax would apply to amounts paid for tickets sold on or after 10 days after enactment of the bill for transportation which begins on or after that date. It is estimated that this tax will improve our balance of payments by \$50 million per year and raise \$95 million in revenue each year.

We are in basic agreement with the provisions in the bill as they affect the ticket tax.*

* The Treasury Department suggests two changes in the ticket tax provisions of H. R. 16241:

(1) The House bill, while eliminating most exemptions, retains the present exemption for domestic flights by small aircraft on nonestablished lines (sec. 4263(d)). The retention of this exemption is inconsistent with the user charge nature of the domestic ticket tax and it is recommended that it be deleted.

(2) The Treasury Department recommends excluding from the ticket tax flights completely within Puerto Rico (or, consistently, within one of the possessions) in that this is more in the nature of an internal matter of concern to Puerto Rico under its Commonwealth status.

2. Customs Measures

a. Balance of Payments Impact of Present \$100 Duty-Free
Tourist Exemption

The estimated value of articles acquired abroad and brought into the United States during 1967 by United States residents returning from countries other than Mexico and Canada, and the Caribbean area totaled approximately \$200 million. Of this amount, \$100 million was brought in under the present \$100 customs duty-free exemption granted to returning residents. A substantial reduction in this duty-free exemption would achieve a significant reduction in the value of articles brought into the United States by returning United States residents.

b. Balance of Payments Impact of \$10 Gift Exemption for
Parcels Arriving by Mail

An estimated 11 million packages arriving by mail during 1967 were admitted duty free under the existing exemption for gifts valued at less than \$10. In addition, many other parcels presently being admitted without payment of duty would have duty owing if there were adequate customs manpower available to assess the duty. The elimination

of the \$10 gift exemption, and a more intensive processing by Customs of packages arriving from abroad by mail would bring about a decline in the shipment of such parcels to the United States. Since many such parcels are purchased by United States residents, this would result in a significant balance of payments saving.

c. Reduction of Returning Resident Exemption

I. Introduction

I have set forth below, for purposes of convenience and of clarity, a table indicating customs exemptions for returning residents: (1) under present law; (2) under H. R. 16241; and (3) under the proposal that I am now about to make to you. During the rest of my statement, you may find it useful to refer back to this table.

RETURNING RESIDENT EXEMPTION

<u>Location</u>	<u>Present Law</u>	<u>House Action</u>		<u>Treasury Proposal</u>	
		<u>Temporary (until 10/15/69)</u>	<u>Permanent</u>	<u>Temporary (until 10/15/69)</u>	<u>Permanent</u>
Canada & Mexico	\$100	\$100	\$100	\$100	\$100
Caribbean Area	100	10	50	100	100
Virgin Islands, American Samoa and Guam	200	100	200	200	200
Elsewhere	100	10	50	10	50

II. House Action

In order to reduce foreign expenditures by returning United States residents and thereby achieve a balance of payments savings, we had proposed legislation to the House of Representatives which would permanently reduce the present \$100 duty-free exemption granted to returning United States residents to \$10 for persons returning from countries other than Canada, Mexico and the Caribbean area.

The House agreed that a reduction to the \$10 level was presently warranted in view of the current United States balance of payments problems. However, the House concluded that on a permanent basis, commencing in October, 1969, the United States should adopt an exemption of \$50, which is the exemption which the Organization for Economic Cooperation and Development has recommended that all countries grant to their returning residents.

III. Proposed Changes in House Action

A. Exemption for Canada and Mexico

The House left a permanent exemption for Canada and Mexico of \$100. We basically agree with this decision because of the special relationship between the United States and those countries.

B. Exemption for Caribbean

The House reduced the exemption proposed by the Treasury for persons returning from the Caribbean area, from \$100 to \$10 on a temporary basis, and provided that it would be established at \$50 on a permanent basis. I believe the Senate will wish to weigh carefully the desirability of a \$10 exemption for the Caribbean area, even on a temporary basis. The economies of these small islands are largely dependent on United States tourism and a drastic reduction in the customs exemption will adversely affect their economies and their overall trade with the United States. Moreover, we have a special relationship with the Caribbean area similar to that which exists with our contiguous neighbors of Canada and Mexico and this makes it reasonable for all these areas to be given the same treatment. We propose, in short, that the exemption for residents returning from the Caribbean area be retained at the present \$100 level.

C. Exemption for Virgin Islands, Guam and American Samoa

The House bill provides that the present \$200 exemption for residents returning from the Virgin Islands and certain other United States insular possessions be temporarily reduced to \$100 and returned to the present \$200 exemption level in October, 1969.

In order not to disadvantage the Virgin Islands economy, it would be desirable to continue the \$100 differential in customs exemptions between the Virgin Islands and the Caribbean area. Following this approach we recommend that the exemption for the Virgin Islands be retained at the present \$200 level permanently.

D. Summary of Proposed Changes

In summary, with regard to returning United States residents, we propose that the present \$100 exemption be retained for the Caribbean area as well as for Canada and Mexico. For United States residents returning from the Virgin Islands, and certain other United States insular possessions, the present \$200 exemption should be retained permanently. For returning residents from other areas of the world, the present \$100 exemption should be reduced to \$10 now, but increased on a permanent basis to \$50 in October, 1969, as in the House bill.

d. Modification of Gift Exemption for Parcels Arriving
by Mail

We also proposed, and the House Report concurs, that the \$10 duty-free gift provision for articles arriving in the mail from abroad should be reduced to \$1. This will be accomplished administratively under existing law. No change is proposed in the \$50 gift exemption applicable to gift parcels arriving from the United States servicemen serving in combat zones. Moreover, we do not plan to make a change in the \$10 gift exemption level for servicemen in non-combat zones.

e. Modification of Duty Assessment Procedures

In order to minimize the increased customs workload implicit in the changes described above, we recommend simplification of duty assessment procedures applicable to returning United States residents and to certain non-commercial mail parcels.

I. House Action

The House bill provides that for returning United States residents a 10 percent flat rate of duty should be assessed on the fair retail value of all dutiable articles accompanying arriving travelers, provided their aggregate value, exclusive of any duty-free articles, does not exceed \$500 wholesale.

The flat 10 percent rate of duty would also be applied on the fair retail value of non-commercial importations of dutiable articles, arriving by mail, express, and other means of transportation, which are valued at more than \$10 retail but not over \$250 wholesale, exclusive of duty-free articles. A \$1 charge would be made on dutiable non-commercial parcels arriving by mail valued at between \$1 and \$10.

II. Proposed Changes in House Action

We believe the following modifications of these simplified duty assessment procedures are desirable in order to foreclose their becoming a possible avenue for substantial importations of high duty items. The intent of these modifications is to circumscribe the situations where the simplified procedures may be used.

A. Ceiling on Use of Flat Rate by Arriving Travelers

1. General

The flat 10 percent rate would not apply if the aggregate retail value of articles brought in by returning residents exceeds \$100. Under this proposal, the flat rate would not be applicable to persons arriving from areas benefiting from an exemption of \$100 or more. Under the Treasury proposal, these areas are Canada, Mexico, the Caribbean Islands area, and the Virgin Islands and certain other United States insular possessions.

2. Operation of Flat Rate

This is how the flat rate will work. If the tourist has more than \$100 worth of purchases with him, the flat rate will not be applicable to any of his purchases, and he will have to pay duty on the dutiable articles at the Tariff Schedule rates, due allowance being made for the duty-free exemption to which he is entitled. In totaling the tourist's purchases to determine whether the \$100 ceiling has been exceeded, all dutiable articles would be counted, including those articles falling within the tourist exemption. If the purchases of the returning resident do not exceed the \$100 ceiling, when calculated in this manner, he will pay duty at the flat 10 percent rate on all his dutiable purchases, due allowance being made for his duty-free exemption.

The same basic rule would apply in cases where the returning resident exemption becomes \$50 permanently.

In other words, the flat rate would continue to apply to dutiable purchases between \$50 and \$100. If the dutiable purchases exceed the \$100 ceiling, then all purchases above the \$50 exemption become subject to duty at the Tariff Schedule rates.

B. Applicability of Flat Rate for Noncommercial Shipments

1. Increase in Flat Rate

For noncommercial articles arriving in the mail or by other means of transportation, we propose that the flat rate of duty be increased from 10 percent, as provided in the House bill, to 15 percent. In the absence of such increase, travelers desiring to avoid the impact previously described of the \$100 tourist ceiling on the use of the flat rate, would be tempted to arrange for some of their purchases to be separately shipped. The increase proposed would help to discourage such separate shipments.

2. Ceiling on Use of Flat Rate

The flat 15 percent rate for noncommercial mail parcels would not apply to shipments exceeding \$50 in retail value. Where the \$50 limitation is exceeded, the Tariff Schedule rates would be applicable to all dutiable items in the parcel.

3. Charge on Small Value Parcels

To coincide with the 15 percent flat rate, we propose that the charge on dutiable parcels valued at \$10 or less

retail, be increased from \$1 to \$1.50. Articles valued at \$1 or less, would continue to be free of any duty or charge.

f. Resulting Balance of Payments Savings

It is estimated that implementation of all of the above recommendations will achieve a balance of payments savings of about \$100 million during the first year after enactment. This saving would be reduced to \$75 million, on an annual basis, after October 1969 when the basic tourist exemption is scheduled, under the House bill, to be increased from \$10 to \$50.

g. Increased Administrative Costs for Customs and Post Office Department

Implementation of the above measures will entail increased administrative costs for the Customs Service, and also for the Post Office Department to the extent its expense in collecting the duty on parcels arriving by mail cannot be covered by postal handling charges because of the ceiling set under the Universal Postal Union Convention. Their ability to execute these measures is dependent upon adequate increased appropriations to implement the changes. However, I should point out that any increased cost will be offset by significantly increased revenues.

IV. Conclusion

In conclusion, I urge that this Committee take immediate and affirmative action to narrow the balance of payments deficit in our foreign travel account. The first step is to approve, subject to the revisions we have recommended, the extension of the air ticket tax and the customs measures included in H.R. 16241. The second is to add to this bill the tax we have proposed to encourage restraint in foreign travel spending. In this form, H.R. 16241 would represent a balanced and effective program for dealing with the important balance of payments problem in the travel area. Solution of this problem, in turn, is critical if we are to improve our overall balance of payments deficit -- an improvement that is so necessary to maintain strength and confidence in the dollar.

TECHNICAL EXPLANATION
FOREIGN TRAVEL TAX

The following is a technical explanation of the Treasury Department's proposed foreign travel (expenditure) tax.

In General.--Under this proposal, a temporary tax would be imposed on certain expenditures in connection with a trip outside the nontaxable area (generally the Western Hemisphere and possessions of the United States) by a United States person. The tax base would include both expenditures made by him and those made by another United States person on his behalf. The tax schedule would be as follows: The first \$15 of daily expenditures (computed on the basis of an average over the whole trip) would be exempt from tax. All expenditures over this level would be taxed at a 30 percent rate.

The cost of sea or air transportation to and from the traveler's foreign destination would be taxed at a 5 percent rate--either as part of the expanded air transportation tax proposed by H.R. 16241, or as part of the expenditure tax. In addition, all air transportation while abroad would be taxed at a 5 percent rate, either under H.R. 16241, or, if that is not applicable, as a part of the expenditure tax but at a 5 percent rate. The use of the lower ticket tax rate removes the possibility of hardship in the case of persons whose purposes of travel can only be accomplished with numerous flights and frequent

stopovers, as, for example, symphony orchestras on tour. The use of this rate also eliminates the possibility of discrimination between intra-European trips (where the flights tend to be short and therefore relatively inexpensive) and trips in other parts of the world where flights tend to be longer and therefore more expensive.

The application of the rate schedule in the case of families traveling together is discussed in a subsequent part of this memorandum.

United States Person. -- The tax applies to expenditures made in connection with a taxable trip of a United States person. Except as noted below, the traveler would be liable for the tax on all expenditures in connection with his trip, which he himself makes or which are made on his behalf by another U.S. person. Amounts paid directly by an employer for meals and lodging of an employee while on a taxable trip would be taxable foreign travel expenditures of the employee as would the expenditures made directly by the employee (whether or not reimbursed). If a student travels abroad during the summer on funds given to him by his parents, he is taxable on the expenditures of his trip, whether he pays them or whether his father pays them directly. It is consistent with the nature of the tax -- which is to tax the value of facilities and services received on a foreign trip -- to tax the traveler on the entire value of his trip.

Where a United States person on a taxable trip makes expenditures for another person in the taxable area such as entertainment of a friend

(whether or not a U.S. person) or payment of the family expenses of those accompanying him, the expenditures would be taxed to the person making them.

A United States person means:

- (a) Any individual who is a resident in the United States, other than certain employees of international organizations or foreign governments and their staffs and families,
- (b) A corporation or a partnership engaged in trade or business in the United States,
- (c) An estate or trust which is considered a United States person within the meaning of section 4920(a)(4) (relating to the Interest Equalization Tax),
- (d) The United States or any agency or instrumentality thereof,
- (e) A State, including the District of Columbia, Puerto Rico and the possessions, or a political subdivision or any agency or instrumentality thereof, and

(f) A foreign corporation not engaged in trade or business in the United States 50 percent or more of the voting stock of which is owned by a United States person.

United States.--For this purpose, the United States includes the States, the District of Columbia, the Commonwealth of Puerto Rico and all possessions. Thus, residents of Puerto Rico, the Virgin Islands, Guam, and American Samoa, will be subject to the expenditure tax on their travel outside the nontaxable area. A tax on expenditures by such residents while traveling abroad is consistent with the fact that the foreign expenditures of these areas are considered in United States balance of payments. On the other hand, there would be no tax imposed upon expenditures made while traveling in any of these areas. Thus, these areas would be treated in the same manner as the continental United States. Any revenue collected under the expenditure tax from residents of Puerto Rico, the Virgin Islands, or Guam will be covered into the treasuries of those areas.

Taxable Trip.--Only those expenditures in connection with a "taxable trip" would be subject to the expenditure tax.

Commencement and Conclusion of a Taxable Trip.--A taxable trip of an individual shall in general commence with the individual's departure from a port or station in the United States, including the possessions and Puerto Rico. However, since trips within the specified

nontaxable area, primarily the Western Hemisphere, are not subject to the expenditure tax, if the individual after leaving the United States stops at a port or station in the nontaxable area for a scheduled interval of more than twelve hours, the taxable trip shall not begin until his departure from the last such port or station in the nontaxable area. The taxable trip shall end when the individual returns to a port or station in the United States; or, if he makes a prior stop at a port within the nontaxable area at that time, provided the stop is for a scheduled interval of more than twelve hours.

The tax will only be applicable to taxable trips beginning more than 20 days after the date of enactment of the legislation. The tax will terminate on October 15, 1969, which marks the end of the European travel season for 1969. If a person is on a trip on the termination date, he would pay tax only on the part of his trip falling within the term of the tax.

Nontaxable area.--The nontaxable area means the area lying west of the 30th meridian west of Greenwich, and east of the 130th meridian west of Greenwich, and all of Canada, the United States, its possessions and the Trust Territory of the Pacific Islands.

Certain Trips Excepted

Individuals establishing foreign residence.--An individual who, after his departure from the United States, establishes his residence in a foreign country would be considered on a nontaxable trip,

Students and Teachers.--An individual (and his dependents) would be considered on a nontaxable trip if he is enrolled at and attending, or employed as a member of the faculty at, a foreign school or university for a normal school term of at least one quarter. In the case of the student, he would have to be studying for a degree at the foreign school or would have to receive credit for such schooling towards a degree at a domestic school in order to qualify.

Trade or Business.--An individual (and his dependents) shall be considered on a nontaxable trip if he is outside the nontaxable area for at least 120 consecutive days while engaged on a full-time basis in a trade or business or profession. This category of exceptions will cover, for example, an employee transferred abroad by his employer for more than 120 days, or a professor on sabbatical leave abroad doing research on a full-time basis in connection with his trade or business. In addition, a resident (and his dependents) of the United States who is an employee of an international organization traveling on business would be considered on a nontaxable trip, regardless of the length of stay. Moreover, such an employee (and his dependents) present in the United States on nonresident immigrant status would not be subject to the tax whether his trip was business or pleasure.

Partial Vacation Trips and Early Return to the U.S.--If the student, teacher, employee, or businessman meets the time qualifications for exemption described above and does not spend a total of more than 14 days outside the nontaxable area before and after the period he is carrying on exempt activities, his entire trip would be exempt. If he stays longer than 14 days, thus converting his trip to a partial vacation trip, he (and his dependents) would be considered on a taxable trip, but would be permitted to exclude all expenses incurred during the period he is engaged in the exempt activities.

If the student, teacher, employee, or businessman does not stay abroad for the prerequisite time period, his trip would be taxable unless he could not have reasonably foreseen the circumstances which caused him to cut his trip short.

Military. A member of the armed services (and his dependents) who is serving on active duty and is assigned to duty in the taxable area would be considered on a nontaxable trip during his tour of duty at that duty station. Any trips he makes back and forth to the nontaxable area during that tour would also be exempt.

Crew Members of Ships or Airlines. An individual would not be considered on a taxable trip while he is serving as a member of a crew of a facility providing transportation to or from a port or ports outside the nontaxable area provided that the portion of the trip outside the nontaxable area does not include any period of layover longer than normally provided in similar situations.

Taxable Foreign Travel Expenditures. -- In general, unless specifically excluded, the tax applies to all expenditures in connection with the taxable trip of a United States person made by him or another United States person. They include not only the traveler's own living expenses, but also the cost of any entertaining he may do and the cost of most tangible personal property he may purchase while abroad. Expenditures for the use or maintenance of property while on a taxable trip, such as rent for an apartment or automobile, are taxable foreign travel expenditures. In the case of an automobile, boat, other vehicle, or housing accommodation purchased or owned by the traveler, or furnished free of charge by another United States person, a special rule would tax the value of the use of that item during the taxable trip. Consistent with this rule, the purchase price of such property would not be subject to tax.

The value of the use of the article while traveling appears to be a more appropriate tax base than the full purchase price, since this treatment will put the person who purchases or borrows a vehicle or housing accommodation in the same position as one who rents one.

Only expenditures made for facilities or services to be provided on the taxable trip would be considered made in connection with the trip. Thus, any expenditures for pre-trip facilities or services, such as taxi fares to the airport in the United States; costs incurred during the trip for facilities and services not provided on the trip, such as in connection with the traveler's house in the United States while he is gone; or the cost of work done after the traveler's return, such as to repair damages occurring on the trip, would not be taxable foreign travel expenditures.

Expenditures of a taxable trip are taxable whether paid before, during or after the trip. For example, hotel bills are taxable foreign travel expenditures whether prepaid to a travel agent, paid in cash or by check while on the trip, or charged and paid for after return.

Consistent with the rules on deductibility for income tax purposes of ordinary and necessary business expenses, the expenditure tax imposed on amounts deductible as business expenses would itself be deductible.

Purchase of Property. -- In general, amounts spent while on a taxable trip for the purchase of tangible personal property (other than property held for investment or purchased for use or sale in carrying on a trade or business, or by an organization exempt from income tax) would be taxable. Moreover, the cost of property purchased for delivery to an individual on a taxable trip would be taxable. Thus, for example, if a person purchases a European suit of clothes (whether before leaving or while on a taxable trip) and takes physical delivery while on a taxable trip, the purchase price would be a taxable foreign travel expenditure. Or conversely, if a person purchases the suit while in the taxable area for delivery after his return to the United States, the purchase price would be subject to this tax. As mentioned above, in the case of the purchase of automobiles, boats, or other vehicles, there would be imposed, in lieu of a tax on the purchase price, a tax on the value of the use of the article during the taxable trip. The tax in all these cases would be in addition to any applicable customs duty.

Business Expenses. -- In the case of an individual traveling on a taxable business trip or on a taxable trip on behalf of an organization exempt from income tax, his business expenses, or expenses incurred in carrying out the purpose of the exempt organization, other than for transportation, meals, lodging, gifts and entertainment, would be excluded from the tax base.

Rate of Tax

The taxable foreign travel expenditures made in connection with a taxable trip of a United States person shall be subject to tax at the following rates:

Air Transportation in Connection with Foreign Travel.--The expenditure tax will not apply to the cost of any air transportation paid for in the United States. That transportation will be subject to the expanded ticket tax under H.R. 16241 at a 5 percent rate. If the air ticket is not subject to the ticket tax in H.R. 16241, because it is purchased outside the United States or before the effective date of the expanded air transportation tax, the expenditure tax will apply but only at a 5 percent rate. The cost of transportation exempt from the ticket tax under a specific exemption (e.g., transportation furnished to international organizations) would not be subject to the expenditure tax.

Sea Transportation in Connection with Foreign Travel.--The expenditure tax will apply to the cost of all sea transportation in connection with foreign travel in the taxable area. In the case of sea transportation to the first and from the last scheduled stop in the taxable area of more than 12 hours, the rate of tax will be 5 percent. The cost of other sea transportation in the taxable area will be subject to the regular expenditure tax schedule, in the same manner as the cost of land transportation.

Amounts paid for food and services (where no separate charge is made), and seating or sleeping accommodations, during the period transportation is subject to the 5 percent tax rate shall also be taxed at the lower 5 percent rate. Thus, if a United States person takes a 30-day cruise leaving from the U.S. which makes no stops within the non-taxable area and which makes its first stop in the taxable area of more than 12 hours on the 5th day and makes the last such stop on the 25th day, one-third of the cruise fare plus any separate charge for sleeping accommodations will be subject to tax at a 5 percent rate under the expenditure tax. The remaining two-thirds of the cruise fare and separate sleeping accommodations charge and any additional expenditures (such as for sightseeing or food) not covered by the basic fare will be subject to the expenditure tax at the regular rate.

All Other Taxable Expenditures.--All other taxable expenditures will be taxed on the following basis:

(a) Exclusion from tax.--Each traveler is entitled to a \$15 daily exclusion from the expenditure tax base. The amount excludable under this provision for a taxable trip shall be computed by multiplying the number of days during any part of which the individual was on such taxable trip by \$15 to arrive at the total exemption.

(b) 30 Percent Rate.--The remaining expenditures shall be subject to tax at the rate of 30 percent.

For example, if a corporate employee goes to London on business for 10 days and spends \$200 for taxable expenditures (whether or not he is reimbursed by his employer) he would pay a tax of \$15 computed as follows:

				<u>Tax Rate</u>	<u>Tax</u>
Exclusion	\$15	x 10 days =	\$150	0	-0-
Remainder -	30% rate		50	30%	\$15
		Total:	<u>\$200</u>		<u>\$15</u>

If in addition to his plane fare to London, the employer directly paid for the employee's hotel bill of \$200, the employee would also include this amount in his tax computation. Under the above example, his tax would be increased by \$60 (to a total of \$75).

Computation of the Tax

In order to preclude the necessity of travelers having to keep detailed records of their expenses, taxable foreign travel expenditures would be computed, to the greatest extent possible, by a travel net worth method. For many people this would involve merely subtracting the money and traveler's checks with which they returned from the money and traveler's checks with which they left and adding this to the amounts paid before the trip began.

More specifically, the first step in the computation for all travelers would be to determine the cash expenses of the trip. To do this, the amount of money (including traveler's checks) with which a person returns from a taxable trip would be subtracted from the sum of the amount of money (including traveler's checks) with which he departed plus all amounts received while on the taxable trip. Amounts received while on the trip

must be included regardless of their origin. Thus, withdrawals from domestic or foreign banks, money sent from home, compensation for services received while abroad or money received from the sale of property would be included.

The second step in the computation would be to add to the cash expenditure figure, the amounts of expenditures in connection with the taxable trip paid before the taxable trip began, the amounts charged while on the taxable trip, and the amount of checks written while on the taxable trip. These are all amounts of which the traveler will have a record, e.g., credit card statements, personal check stubs. The resultant figure would represent the tax base for most travelers, and would be taxed according to the per day exemption and 30 percent rate, or in the case of certain transportation, the 5 percent rate of tax. For others, a further reduction would be made for expenses specifically excludible from taxable foreign travel expenditures (such as the cost of business inventory). The figure resulting from these reductions would represent their taxable foreign travel expenditures.

Estimated Tax

Every individual, at his point of departure from the United States for a period during which he reasonably expects to be on a taxable trip, and whether or not he plans to make a stopover in the nontaxable areas, would be required to make a declaration of his estimated tax with respect to that taxable trip and pay the amount of the estimate to the Internal Revenue Service. He would include in his declaration a statement of the amount of cash (and traveler's checks) he is taking on the taxable trip. This figure is necessary in order to utilize the travel net worth method for computing cash

expenditures. Appropriate procedures will be developed for filing the declaration so that compliance with the requirement may be verified before the traveler's departure. The accuracy of the cash statement would be subject to verification at the point of departure by customs officials or other Treasury officials.

If a United States person departs on a taxable trip from a port in the nontaxable area outside the United States, and he did not make the required declaration and statement upon leaving the United States, he will be subject to penalty unless he can show such departure was not expected. In any event, the declaration or statement, if not previously filed, would be filed at this time.

Any individual returning from a taxable trip would be required to make a statement of his incoming cash (and traveler's checks) at the time he is processed through United States Customs. This statement would provide the incoming cash balance from which the travel net worth would be computed, and the accuracy would be subject to verification by a customs official.

Returns and Payment of Tax

A tax return for a taxable trip, together with payment of any balance due, would be required to be filed with the Internal Revenue Service by the traveler within 60 days after his return. This will allow the taxpayer adequate time to receive all necessary credit card and banking records for preparation of the return. Of course, the return may be filed immediately upon arrival. A husband, wife,

and any of their dependent children who travel together on a taxable trip may make a single taxable trip return jointly with respect to such trip. Such a return may be filed even though one or more of such individuals has no taxable foreign travel expenditures. A joint return would allow a family to utilize the full per diem exemption available to each traveling member without requiring that each have separate expenditures to absorb them.

Administration and Procedure

Generally the administrative and procedural requirements applicable to other excise taxes would be applicable to this expenditure tax. Thus, for example, the general provision for penalties for failure to file returns, requirements for claims for refund, assessment and collection procedures, and statutes of limitations would apply to the administration and procedure of this tax.

Two new provisions would be added to insure compliance with the requirements for declaration and payment of estimated tax.

A flat penalty of \$200 would be imposed for failure to make a declaration of estimated tax and statement as to cash on hand, as required at the time of departure from the United States unless it were shown that such failure was due to reasonable causes. Thus, if an individual flew from New York to Europe without making a declaration and statement, a \$200 penalty would be imposed for failure to make the declaration in New York. A significant penalty is necessary because of the importance of having an individual establish his outgoing cash figure for purposes of computing

the tax base. An underestimation penalty would be imposed of 10 percent of the underpayment of estimated tax. The amount of the underpayment would be the difference between the estimated tax payment and the amount of tax shown on the taxable trip return.

TECHNICAL EXPLANATION
PROPOSED CHANGES IN CUSTOMS RULES RELATING TO TOURIST
EXEMPTIONS AND PROCESSING OF CERTAIN NONCOMMERCIAL
IMPORTATIONS

The proposal is intended to reduce noncommercial expenditures of dollars abroad where such expenditures adversely affect our balance of payments. It would do this by lowering the duty-free exemptions allowed returning U.S. residents. In order to ease the administrative burden of processing millions of dutiable non-commercial foreign acquisitions brought back to this country by returning U.S. residents and millions of dutiable noncommercial mail shipments, it would provide for a flat rate of duty on such articles within certain monetary limits.

At the same time, since the proposal deals only with noncommercial imports, it would not interfere with the favorable balance of payments aspects of our trade account or the legitimate business interests of American businessmen in the import trade.

The proposal would not assess any duty or charge on articles which are themselves free of duty under existing provisions of the Tariff Act. Most of such articles would be works of art, books, American goods returned, United States origin personal effects of residents abroad and similar items.

The Reduced Tourist Exemptions

A. Present Practice .

The present tourist exemptions granted to returning U.S. residents permit the duty-free importation of foreign acquisitions not exceeding

a total retail value of \$100. This exemption is granted to American residents who have been abroad for not less than 48 hours and may be used only once each 31 days (in the case of persons arriving from Mexico the 48-hour time limit is waived). The resident is permitted to include within this exemption one quart of alcoholic beverages. This exemption is applicable to residents returning from any area or country. However a special exemption is granted to residents arriving from the Virgin Islands and certain other U.S. insular possessions. This special exemption permits the importation of acquisitions up to a value of \$200 retail, of which not more than \$100 may be acquired outside the Virgin Islands or other insular U.S. possessions, and may cover not more than one gallon of alcoholic beverages of which not more than one quart may be acquired outside the Virgin Islands or other insular possessions.

B. House Bill .

The House bill contains the following exemption structure (computed on retail values as under existing law): (1) The exemption for U.S. residents returning to the United States from any place other than Canada, Mexico and certain United States insular possessions would be \$10 on a temporary basis and \$50 on a permanent basis after October 15, 1969; (2) the exemption for residents returning directly from Canada and Mexico would be \$100 permanently and (3) the exemption for residents returning directly or indirectly from the Virgin Islands

and certain of our other insular possessions would be \$100 temporarily until October 15, 1969, when it would be restored to the present \$200 level.

As under existing law, exemptions in excess of the minimum exemption would be restricted so that goods acquired would be exempt only to the extent of the exemption applicable to the area of acquisition. For example, the exemption for a tourist returning from the Virgin Islands after October 15, 1969 (when the \$200 exemption would be in effect) would be limited to \$100 in Canada or Mexico no more than \$50 of which were acquired in Europe. Goods in excess of these amounts acquired in these areas would be dutiable, even though, in the aggregate, they did not exceed \$200.

Foreign acquisitions accompanying the returning U.S. resident valued in excess of the exemption would be dutiable at a flat 10 percent of the fair retail value. The 10 percent rate would be applied on such articles up to an aggregate value of \$500 wholesale. If dutiable acquisitions above the exemption level exceed \$500 in wholesale value, all dutiable articles would be assessed duty at regular Tariff Schedule rates. In addition to any customs duties, articles such as liquor and tobacco would, of course, be subject to any applicable Internal Revenue taxes.

C. Current Treasury Proposals.

For the reasons set forth in the Statement by the Secretary of the Treasury, the current Treasury proposals would modify the House bill by:

1. Extending the exemption level of \$100 for Canada and Mexico to the Caribbean Island Area. 1/
2. Retaining the present \$200 exemption for U.S. residents arriving directly or indirectly from the U.S. Virgin Islands and certain other insular possessions. The same limitations on the exemptions for goods acquired in other areas would be provided, but at the changed exemption levels that would be applicable to those areas of acquisition.
3. Reducing the \$500 wholesale ceiling on applicability of the flat rate to \$100 retail.
4. Including acquisitions exempt from duty solely by virtue of the tourist exemption within the \$100 ceiling for purposes of determining applicability of the flat rate.

Articles Not Accompanying Returning Travelers.

A. Present Practice.

At present, low value items (under \$1) such as newspapers are "passed free." The same "passed free" status is given to mail parcels

1/ The Caribbean Island Area would be defined as the Bahama Islands, the Turks and Caicos Islands, the Bermuda Islands, and all the islands in the Caribbean Sea except those belonging to Central and South American countries, Cuba and its offshore islands and Puerto Rico, the Virgin Islands of the United States and all other islands of United States sovereignty.

identified as gifts valued at up to \$10 retail and to gifts (whether imported by mail or otherwise) valued up to \$50 retail from servicemen in combat areas.

All other dutiable articles, whether imported by mail or otherwise, are subject to the Tariff Schedule rates.

B. House Bill.

The \$10 exemption for all mailed gift parcels, with the exception of those originating in noncombat areas, would be reduced to \$1 retail administratively by a change of regulation. The statutory exemption of \$50 for gifts from servicemen in combat areas would also be retained as would the \$10 exemption for servicemen in non-combat areas.

C. House Bill.

Dutiable mail shipments valued at over \$1 and not over \$10 retail would be assessed \$1 in lieu of any other duty or tax.

Dutiable mail shipments valued at over \$10, and dutiable shipments by other means, containing more than one article and valued at not over \$250 wholesale, would be assessed duty at a flat rate of 10 percent of the fair retail value.

Shipments containing one article or exceeding the \$250 ceiling would be assessed duty at regular Tariff Schedule rates.

D. Current Treasury Proposals.

For the reasons set forth in the Secretary's Statement, the current Treasury proposals would modify the House bill by:

1. Increasing the flat charge for mail packages valued at over \$1 and not over \$10 retail, to \$1.50.

2. Reducing the \$250 wholesale ceiling on applicability of the flat rate to \$50 retail.
3. Increasing the flat rate from 10 to 15 percent.
4. Extending the flat rate to single article packages.

Estimated Foreign Expenditure Reductions

A. Changes in Tourist Exemptions .

During 1967, the total value of foreign acquisitions made by returning U.S. residents arriving from all foreign countries was estimated to be in excess of \$362 million. Of this total, persons arriving from Canada, Mexico and the Caribbean countries (including Caribbean cruise passengers) accounted for slightly over \$162 million. Therefore, the value of articles acquired by returning U.S. residents arriving from other countries was approximately \$200 million. Approximately \$110 million was brought in by persons whose purchases totaled less than \$100 per person, while approximately \$90 million was brought in by persons whose foreign acquisitions exceeded the present duty-free exemption.

We estimate that the value of foreign acquisitions by persons now bringing in less than \$100 each will be reduced by \$45 million or approximately 40 percent of the total purchases made by this group.

The effect on foreign acquisitions made by the approximately 300,000 persons who now exceed our duty-free exemption and pay duty

would be somewhat less. If we can assume that the foreign acquisitions by these persons will be reduced by an amount roughly equivalent to the additional duty which they would have to pay, the total reduction in foreign acquisitions by this group of returning U.S. residents would be about \$5 million.

Thus, the total reduction in foreign acquisitions to be achieved by reducing the tourist exemption to \$10 is estimated to be approximately \$50 million on an annual basis through October 15, 1969. After that date, when the increased exemption for most of the world applies, the total reduction will approximate \$30 million on an annual basis.

B. Mail Shipments .

It is estimated that the total value of the 55 million mail parcels which arrived in the U.S. during 1967 was approximately \$500 million. Of this 55 million total, an estimated 11 million parcels were gifts or purported gifts said to be valued at less than \$10; 4 million were gifts valued \$50 or less from servicemen in combat areas; and 25 million were "flats", newspapers, periodicals, samples and shipments of insignificant value. Of the remaining 15 million parcels duty was assessed on 1,600,000 parcels. However, our studies indicate that approximately one-third of the 15 million parcel total would have been dutiable if adequate manpower was available to properly handle them.

Certain parcels now included in the present \$10 gift exemption are bona fide gifts mailed from nationals of foreign countries to persons in the United States. While elimination of this privilege with respect to such parcels will not affect expenditures of U.S. dollars abroad, it is nevertheless believed necessary to eliminate this free-gift privilege entirely because it is subject to widespread abuse and because, in practice, it would be exceedingly difficult to distinguish between gifts from foreign nationals and those from U.S. tourists.

Of the 11 million gift parcels under \$10 we estimate approximately 4 million from U.S. tourists would be discouraged if the existing gift exemption were eliminated. The average value of these parcels is estimated to be \$7. Therefore, foreign expenditure curtailment of approximately \$28 million would be achieved. The application of a flat rate of duty to the remaining noncommercial shipments would simplify Customs' administrative task. Customs would be able to assess duty on an appreciable number of packages which now escape duty simply because Customs manpower cannot cope adequately with the number of packages involved. Closing this loophole will probably deter the sending of a number of these packages. It is a conservative estimate that approximately an additional \$12 million reduction in foreign acquisitions, for a total of about \$40 million, will result from the above-proposed changes in the Customs processing of foreign mail parcels.

Estimated Additional Revenue Collections

It is estimated that revenue collections will increase by about \$10 million by reason of changes in the tourist exemptions, and by an additional \$15 million on mail shipments, for a total additional revenue collection of \$25 million.

TREASURY DEPARTMENT
Washington

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Fol. Inv.*

FOR RELEASE ON DELIVERY

REMARKS BY THE HONORABLE FREDERICK L. DEMING
UNDER SECRETARY FOR MONETARY AFFAIRS
DEPARTMENT OF THE UNITED STATES TREASURY
AT THE SIXTH INTERNATIONAL PROGRAM
OF THE
INSTITUTO DE ESTUDIOS SUPERIORES DE LA EMPRESA
UNIVERSIDAD DE NAVARRA
BARCELONA, SPAIN
MONDAY, JUNE 17, 1968, 11:00 A.M. (BARCELONA TIME)

INTERNATIONAL INVESTMENT
AND THE INTERNATIONAL MONETARY SYSTEM

This lecture is divided into three parts -- not mutually exclusive -- in which I consider:

1. Cyclical or short-term balance of payments adjustment, with particular reference to the United States.
2. Secular or longer-term problems of the United States international payments position, with particular reference to the scope for capital investment.
3. The relationship between adequate growth in international reserves and international investment.

First, let us look at the short-run balance of payments adjustment problem. This is the area on which most current attention centers. Here, I believe, two important points should be made.

Point 1 is a very simple one. Every major payments imbalance has two sides. If one abstracts from the input of new monetary reserves into the world's monetary system, the deficit of one country or group of countries will have its counterpart in the surplus of another country or group of countries. Adjustments, therefore, must be made and permitted by both groups -- deficit countries and surplus countries -- to eliminate their respective imbalances, if a healthy world economy is to be maintained.

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Point 2 is that the adjustment process in today's world is a more complex process than it was in the earlier years of this century, and, in many cases, adjustment cannot be achieved satisfactorily solely by the application of broad and general economic policies. There are two primary reasons for this.

One is that the sharp deflationary policies are no longer acceptable -- either on political or economic grounds. Even assuming that sharp deflation may conceivably cure a payments deficit, it may so depress the deficit country's economy that it is unacceptable as a domestic policy and has adverse economic effects on the country's trading partners and, consequently, is unacceptable to them also. It is now generally recognized that deflation was carried too far by some major countries in the 1920's and early 1930's. And it is now recognized that this resulted not only in reduced growth in deficit countries but in the world as a whole. Such a policy is not acceptable today in any country or in the world.

The second reason is that -- at least in many cases -- broad and general deflationary policies can not completely cure a deficit, because important elements in the imbalance are not much affected by such policies. I want to make quite clear that proper fiscal and monetary policies are still the most important elements in achieving both domestic and international payments stability. My point is that, in the modern world, they often need supplementary help to achieve balance of payments equilibrium. In other words, these policies are vital but not necessarily sufficient to do the job.

Let me illustrate by considering the United States. In the United States, general fiscal and monetary restraints appear to have much greater impact on the balance of payments when their effect is to dampen a cyclical boom than when they are applied to stimulate an economy which has much unused capacity. Imports appear to be much more sensitive to a rise in GNP at a rate exceeding 6 percent in monetary terms and much less sensitive when GNP is growing more slowly. Exports show less sensitivity to the domestic growth rate, appearing to be mainly unfluenced in the short-run by the level of activity in foreign markets.

In the United States, general policies of fiscal and monetary restraint are badly needed on both domestic and external grounds. Since late last year, monetary policy has moved, by successive stages, to a much more restraining posture. The accompanying fiscal restraint has, unfortunately, been conspicuous by its absence. But there is now reasonable certainty that the long-sought Congressional approval of a tax increase and expenditure cuts will soon be forthcoming. The favorable impact of the scheduled fiscal measures on the domestic economy and our balance of payments should be clearly registered during the second half of this year -- and in 1969.

From a domestic standpoint, the fiscal restraint will be welcome, indeed. In the first quarter of this year, GNP grew at an unsustainably rapid annual rate of 10 percent. Too much of this fast advance is being reflected in rising costs and prices. Fiscal restraint will hold the advance of the economy to a much safer, less inflationary, pace. Without fiscal restraint, the Federal budget deficit on the new, unified basis would exceed \$20 billion next fiscal year -- for the second time in a row. With fiscal restraint, the deficit will shrink rapidly.

The U. S. economy and the financial markets have been under considerable strain. For example, unemployment rates, while still too high for some disadvantaged groups, are very low by historical standards in some key categories. In the financial markets, some interest rates have reached levels not experienced in the United States for many decades. In such a situation, the persistence of large federal budget deficits is clearly inappropriate, and the long-sought application of fiscal restraint will place the economy's advance on a much sounder basis.

We are in the process of learning how to use fiscal policy more effectively. It is already evident that the use of fiscal policy must allow for political tolerances that can seriously affect both the scope and timing of fiscal action. It is a powerful tool of cyclical policy but not, perhaps, as flexible as may have been assumed by some. This seems to be particularly true when it is to be applied as a restraining factor rather than a stimulus.

Over the longer run, the effects of general economic policies certainly will be felt in the trend of costs and prices. The competitive position may be impaired in a lasting way if costs and prices rise faster than in competing areas. Controlling inflation for some countries seems to be as difficult as dieting. Progress is painful and slow, a brief lapse can quickly lose the progress made by long periods of discipline. For other countries, the reverse seems to be true. They put on weight only by gross indulgence and quickly drop it by a return to a normal diet.

Something like this distinction seems to prevail in the balance of payments field. We have had some persistent deficit countries that have had recurrent inflationary problems, and we have had persistent surplus countries.

Important as fiscal and monetary policies are to promote sustainable economic growth with price stability and to help achieve balance of payments equilibrium, there are some important aspects of the U.S. deficit that are not influenced much by such policies. Thus, we have turned to some selective measures. Similarly, surplus countries have found it necessary to employ new and selective measures to help their adjustment.

Let me cite three important areas where general policies have little or no effect on payments imbalances -- military expenditures, tourism, and some capital flows.

The gross foreign exchange costs of U.S. military expenditures now run about \$4.5 billion a year. Even abstracting from Vietnam, these gross foreign exchange costs -- incurred largely as the United States' contribution to the common defense of the Free World -- run approximately \$3 billion per year. On a net basis -- after allowance for sales of military equipment to our allies and other neutralizing measures and not counting Vietnam -- they have run between \$1.5 and \$2 billion per year.

This heavy drain on our balance of payments is in no sense susceptible to reduction through the application of general fiscal and monetary policies. Nor is it influenced by selective economic policies. Here the solution must be found in international cooperation. Thus, in the NATO Alliance, for example, the principle that foreign exchange costs of common security should be effectively neutralized needs to be implemented in more effective ways.

Our gross expenditures on tourism (including fares to foreign carriers) were about \$4 billion in 1967, and our net outpayments, after allowing for tourist receipts, were around \$2 billion. The foreign expenditures of our tourists have been rising at an average rate of nearly 10 percent a year for the past ten years. This steeply rising trend is related to the growing number of people with higher monetary incomes and to various other causes and would not be appreciably reduced by a slowdown in the general rate of economic expansion in the economy. Here we have used some mild special measures, but look over the long pull toward increasing our tourist receipts rather than reducing our tourist expenditures.

A third important factor is the flow of capital investment from the United States to industrialized countries in Europe, Japan, and elsewhere. Earlier in this century, economists thought of capital investment as flowing from advanced countries to developing countries, largely in the form of goods, rather than money. But, today, we have a tendency for capital to flow in growing volume to Western Europe, without a corresponding outflow of goods and services from the United States.

We have tried to deal with this area through some selective devices -- the Interest Equalization Tax and the Department of Commerce program on direct investment, and the Federal Reserve programs dealing with banks and nonbank financial institutions.

On the whole, these programs have worked well -- they have not stopped capital outflow; that was not their purpose. They have, however, reduced the rate of increase and, thereby, reduced the problem for the time being. They also have had the positive effect of stimulating the growth of European capital markets, which now provide more funds for foreign borrowers than they did in the past.

It is hard to say whether or not the selective U.S. programs have had the tendency to raise interest rates abroad. This is partly because European countries, in the past two years or so, have been running economies with some slack, and their domestic monetary policies have tended to ease -- which is responsible conduct for surplus countries. It is partly because selective policies followed by European central banks have diverted funds from capital inflow back toward international money markets. These steps have eased liquidity and tended to lower interest rates in international markets without

further easing in domestic markets. They probably have led to some domestic borrowers going abroad for funds and perhaps have diverted some short-term funds into long-term capital market channels.

II.

I turn now to the second area I wish to discuss -- the longer term aspect of the U.S. international payments position. Here I want to take two perspectives -- a very broad and long-term one for the period 1941 through 1967, and a more detailed and medium-term one for the last six years, 1961 - 1967.

In the broad and long-term overview I combine all of the balance of payments flows into three broad accounts. First, is the trade and service account. Here I exclude military transactions and investment income, but I include exports financed by Government and pensions and remittances. Second, is the capital account which includes capital outflows, net capital transactions of foreigners and errors and omissions and also includes income flows -- normally included in the service account -- repatriated earnings on investments and loans, both private and Government, and fees and royalties. Third, is the Government and military account which includes sales of military goods and services and Government loan repayments -- in other words, it is net.

For the 17 years from 1941 through 1957, the United States had a cumulative surplus on trade and service account of \$85 billion, or \$5 billion per year. Capital and income investments in that period gave us a plus of \$17 billion, or \$1 billion per year, on the average. On Government and military account we had a cumulative deficit of \$112 billion, or \$6.6 billion per year, on the average. Between 1946 and 1957, we extended economic assistance in grants and loans of \$42 billion net.

The net effect of these results was a cumulative deficit in our payments balance of less than \$10 billion, or an annual average of less than \$600 million. And we gained gold reserves -- at the close of 1957 our gold reserve was larger than at the beginning of 1941. We financed our small deficit completely -- and more -- by increasing our dollar liabilities to foreign official and private holders.

Throughout this period, the U.S. was in fundamental surplus, but, through its deliberate policy of massive untied grant and loan assistance and its absorption of most of the costs of insuring Free World security, we incurred minor balance of payments deficits.

This was enlightened policy -- it encouraged world trade and economic growth. But it had two unfortunate results. It was carried on too long after basic conditions had changed. The deficits got larger and had to be financed both with increased dollar outflows and a reduction of \$11 billion in our gold reserves from 1958 through 1967. Also, it got some of the rest of the world -- particularly Western Europe -- into the bad habit of enjoying chronic surpluses, even after Europe's reserves had been rebuilt. The net result was that both the U.S. and the world got worried about the American deficits, but it took some time for worry to be expressed about the big European surpluses.

From 1958 through 1967, the U.S. had a cumulative deficit of \$27 billion, or \$2.7 billion annual average -- more than four times the average of the previous 17 years. The Government and military account deficit was reduced to \$5.5 billion per year, on the average. That is still a big figure; after mid-1965, it was, of course, affected by Vietnam.

On capital account we stayed about the same -- \$1 billion surplus per year on the average. Capital outflows -- direct investment, portfolio and bank loans -- rose sharply; enough so that the steadily rising income factor just about -- not quite -- kept it in about the same position as in the previous 17 years. But this occurred only after the outflow had been somewhat contained and only after various special transactions.

The big difference is found in the trade and service account. The surplus dropped sharply -- to less than \$2 billion per year, on the average. Exports grew, but, particularly in later years -- imports grew faster. And we had a rapidly increasing deficit on tourist account.

Now, let us take another fix -- medium-term on the U.S. balance of payments. Table A (attached) gives somewhat more detail for the years 1961 and 1967 and shows the net change between them. The data are arranged in somewhat more conventional fashion, with the top half of the table showing essentially the current account and the bottom half the capital flows.

I want to concentrate first on lines 2 through 5 -- net investment income, net services (other than military), net military account and Government grants and credits.

Government grants and credits, net (line 5) grew from \$2.8 billion to \$4.3 billion over the six years. But almost half of the increase was mainly statistical -- there were big debt prepayments in 1961 and virtually none in 1967. Adjusting for this, the adverse change was about \$762 million or 22 percent. Items in this account include, among others, AID disbursements and drawdowns of Export-Import Bank credits. Some \$400 million of the increase is represented by Export-Import Bank loans outstanding. A very large part of the AID disbursements were transferred in kind, in the form of goods and services, thus equalling and offsetting a corresponding amount of exports.

The services account (line 3) which excludes investment income and fees and royalties, but includes pensions and remittances, shows a net outpayment of \$1.5 billion in 1961 and \$2.6 billion in 1967, an adverse change of \$1.1 billion or 73 percent. This account is heavily influenced by tourist expenditures, which, as noted earlier, cost us, net, in 1967 about \$2 billion.

The third account, net investment income (line 2) includes fees and royalties, but also net outpayments of interest and other income to foreigners on their private and public investments in the U.S. Here the figures are positive and the trend advantageous to the U.S. In 1961, the net receipts were \$3.4 billion, and in 1967, they were \$5.6 billion, a gain of 66 percent.

The military account, net, (line 4) shows a deterioration of \$700 million over the six years -- from an outflow of \$2.6 billion in 1961 to one of \$3.3 billion in 1967.

The bottom half of the table shows capital flows. Line 7 shows the capital flows net of "official capital inflow," and line 8 includes such capital inflow. The difference represents mainly investment of official reserves in non-liquid form in the U.S. Part of this figure reflects military neutralization financial transactions, part represents the pull of high interest rates on such investments. Even excluding these investments, it is evident that there was some reduction in capital outflow from 1961 to 1967, reflecting primarily selective capital measures -- the Interest Equalization Tax and the direct investment and financial institutions control programs of the Department of Commerce and the Federal Reserve.

Finally, the first line in the table shows the trade account and its deterioration between 1961 and 1967. Now, let us pull some conclusions out of these figures.

- (1) The rise in investment income more than offset the declines in non-military services and Government grants and capital, if allowance is made for the special debt prepayments of 1961. These three accounts combined showed a net gain of \$400 million from 1961 to 1967. Certainly it is not unduly optimistic to expect further improvements over the future.
- (2) It also is not unduly optimistic to conclude that the net military account should improve over the next few years. Gross expenditures should be reduced when peace comes to Vietnam. And net outflow should be reduced as we and our allies move forward to implement the accepted principle that foreign exchange costs of common defense efforts should be neutralized.
- (3) Real effort must be made to improve the trade account. Gains here can be translated into rising capital exports -- deterioration in the trade account almost automatically leads to capital curbs.
- (4) Capital inflow from abroad can be an important factor in contributing to balance of payments equilibrium for the United States and in permitting additional capital exports from the U.S. The role of the U.S. as a financial intermediary needs further exploration.

The detailed examination of the recent six-year period tends to confirm the broad conclusion to be drawn from the long-term picture. The U.S. payments position is strong when its trade position is strong. Without a trade position stronger than that of 1967, the United States would have no margin of real resources to use in net capital exports.

III.

I come now to the last part of my remarks -- the relationship between the growth of international reserves and the flow of international investment over the longer run.

In a sense, one may think of countries as investing part of their national savings in reserves, when they acquire growing amounts of gold and foreign exchange. Resources in goods or securities are being spent to acquire reserves rather than investments abroad or a larger volume of imports.

Almost continuously since 1950 the industrial countries of Continental Western Europe have invested substantial amounts in additions to their reserves. Between 1950 and 1967 the European Community countries added an average of \$1.3 billion to their reserves annually. This is equivalent to 92 percent of the growth in world reserves in that period. Between 1961 and 1967, additions to reserves by this group of countries averaged \$1.4 billion, or about 1 percent of the average increase in their combined Gross National Product.

But even with the investment of considerable amounts in reserves, reserve growth in the European industrial countries in the last ten years has fallen short of expansion in their international trade. And since 1962, in these countries, reserves have declined in relation to GNP.

These facts give rise to several interesting questions. What has determined the proportion of the current account surpluses going into reserves as against capital investment in other countries? Will there be continuing need for reserve additions in Europe at about the previous rate, or at some lower rate? Are the Common Market countries now finding alternative uses for their foreign exchange receipts in capital outflow and will they in the future channel smaller amounts into additions to reserves? If so, what does this signify as to the future pattern of international investment?

A look at what has been happening in the EC countries is instructive. I have attached a table to these remarks showing current surpluses, net capital flow, and overall balances of payments in recent years, 1961-67. The table also shows the percentage increase in official reserves in each of the years 1961-67.

Apart from 1962, when a high level of debt prepayments combined with a declining current account surplus to hold down the increase, the annual rise in official reserves of these countries ranged but narrowly between \$1.3 billion and \$1.9 billion. These fairly regular increases in reserves were achieved in a period when the current account position varied by some \$4-1/2 billion, and the capital account balances by about the same amount.

The table seems to indicate a relative preference for reserve increases as against capital exports -- investments -- even in the face of some capital inflows that were represented as unwelcome. Note that the period 1961-65 was characterized by persistent net capital inflows -- moderate in 1961-63 and substantial in 1964-65.

In 1966-67 there was a marked shift -- the Six invested substantially more abroad than they received in capital inflow. The turnabout in the period was due to the convergence of a number of factors. Undoubtedly the most important was the series of measures taken to slow down capital outflows from the U. S. The period since mid-1963 and particularly since the February 1965 program of the United States has been one of increasingly stronger actions of this type. A related development has been the rapid growth of the Euro-bond market from about \$0.5 billion as recently as 1963 to \$2 billion plus last year. While the identity of purchasers of securities in that market remains veiled, indications are that residents of the Common Market became substantial investors in these securities during the period. Another factor, of course, has been the change in relationships between U. S. and European interest rates. Finally, the change in the pattern of payments surpluses within the Six may have contributed to the emergence as a net capital exporter. The principal development in this respect has been the erosion of the surpluses in Germany and Italy, both of which have demonstrated a praiseworthy propensity to export capital even in the face of some handicaps.

The development in recent years of large European sources of capital for international investment is gratifying. It is one of the most promising signs that progress is being made in achieving a better adjustment in one aspect of the problem of international adjustment -- namely, the relationship between current and capital accounts.

As already noted, 1967 was a year of abnormally large current account surplus for the Continental European countries. What will happen when the current account returns to a lower level, as it must do if the United Kingdom and the United States are to improve their own current account totals? Will Europe continue to export capital and permit reserve growth to skrink, or vice versa? The answer to this question will determine how international investment is to be financed in the future, and may indeed affect the actual physical volume of investment.

However, if Europe continues as a capital exporter, as we hope, even in the face of a declining current account surplus, we should come a long way toward a much better adjusted pattern of international payments. Moreover, this would have been achieved with a minimum amount of frictional strain on the individual economies or slowdown of world investment.

In the absence of new reserve creation, this could mean a substantial decline in the past rate of reserve accumulation on the Continent. It is important that such a leveling off in reserve growth not lead to an excess of caution in monetary and economic policies. Fortunately, the new facility for creating Special Drawing Rights can counter such tendencies, and makes possible both a continued upward movement of European reserves, as well as a continuation of European foreign investment.

To the extent that reserves of the European countries rise as a result of their own allocations of newly-created Special Drawing Rights, they will receive credits on the books of the International Monetary Fund without having exported goods and services or imported capital to acquire these reserves. These reserves can remain passive or can be used. It is largely through the channel of monetary policy, interest rates, and a generally better environment for investment that the new Special Drawing Rights should over time exert their influence, insofar as these reserves are created for countries persistently in equilibrium or surplus.

Countries with a tendency towards a deficit are likely to borrow capital or reserves from abroad. The provision of Special Drawing Rights reduces the need to borrow reserves. To this extent, it should moderate one form of international borrowing. Allocations of Special Drawing Rights would substitute for borrowing and this should decrease demands that might otherwise fall upon international money and capital markets.

Thus, whether looked at from the aspect of surplus countries or deficit countries, the provision of an adequate growth of reserves through Special Drawing Rights should over time act as a stimulus to the level of international and domestic investment. It should help to avoid, or mitigate, tendencies to competitive escalation of interest rates that might otherwise occur as countries seek to build up or protect their reserves, when there is no way to increase the reserves of the world as a whole.

We have found that there has been a substantial shift of the sources of international capital investment from the United States to the EC countries of Europe, corresponding to the shift in the current account surplus, since 1961. At the same time the EC countries have continued to add substantially to their reserves out of the proceeds of the current surplus. We now hopefully expect some decline in the abnormally large trade surplus in Continental Europe, and a recovery of trading position on the part of the United Kingdom and the United States. It will be most constructive if the EC countries can accept adjustment in current account while maintaining the outflow of capital. This would bring all the major countries much closer to equilibrium and it would demonstrate a proper and positive functioning of the adjustment process.

The need for further reserve gains can be supplied by activating the special Drawing Rights facility, without needing to invest current foreign exchange in reserves.

I suggest that this could be a pattern of progress, to the benefit of the world as a whole and especially to countries such as Spain, which have a vital interest in the continued flow of investment funds from the surplus countries to the rest of the world.

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Attachment: Tables A and B

Table A

Selected Groupings of Items from U.S. Balance of Payments
1961 and 1967
(\$ mil.)

	<u>1961</u>	<u>1967</u>	<u>Change</u>
<u>Current Account</u> (incl. U.S. Gov't capital outflow)			
1. Trade Balance	5,444	3,483	-1,961
2. Net investment income	3,397	5,632	+2,235
3. Net other non-military services	-1,475	-2,554	-1,079
4. Net military (cash receipts basis)	-2,564	-3,271	-707
Expenditures	-2,981	-4,319	-1,338
Military cash receipts (incl. mil. adv. payments & repayments on mil. credits)	417	1,048	+631
5. Government grants and capital, net	-2,805	-4,257	-1,452
Gross outflows	-4,054	-5,129	-1,075
Scheduled repayments (excl. mil. credits)	553	866	+313
Advance repayments	696	6	-690
Subtotal (items 2-5)	-3,447	-4,450	-1,003
Total	<u>-1,997</u>	<u>-967</u>	<u>-2,964</u>
<u>Capital Flows</u> (excl. U.S. Gov't capital outflow)			
6. Private U.S. and Foreign Capital (incl. errors & omissions)	-4,462	-4,235	+227
Special U.S. Gov't liabilities other than military advance payments	+95	+353	+258
7. Net (excl. "official foreign capital inflow")	-4,367	-3,882	+485
Official foreign capital inflow	-	+1,274	+1,274
8. Net capital outflow	<u>-4,367</u>	<u>-2,608</u>	<u>+1,759</u>
Liquidity Balance	<u>-2,370</u>	<u>-3,575</u>	<u>-1,205</u>

Table B

BALANCE OF PAYMENTS OF THE EC COUNTRIES, 1961-67

	(Billions of Dollars)							Average
	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967*</u>	<u>1961-67</u>
Current Account Balance	+2.4	+0.8	-0.2	+0.5	+1.3	+2.1	+4.2	+1.6
Capital Account Balance**	+0.4	+0.3	+0.6	+1.6	+1.1	-0.6	-2.7	+0.1
Overall Balance	+2.8	+1.1	+0.4	+2.1	+2.4	+1.5	+1.5	+1.7
Overall Surplus Used to:								
(i) Increase Net Official Reserves	1.9	0.6	1.3	1.8	1.5	1.1	1.4	1.4
(ii) Increase Net Commercial Bank Foreign Assets	-0.4	-0.3	-1.2	0.2	0.7	0.1	0.1	-0.1
(iii) Prepay Official Debt	1.2	0.8	0.4	--	0.2	0.3	--	0.4
Memorandum Item:								
Percentage Change in Net Official Reserves	13.1	3.8	6.8	8.5	6.9	4.1	5.3	6.9

Note: Components may not add to totals because of rounding.

*Partially estimated.

**Includes errors and omissions and net settlements by France on account of Overseas Franc Area.

Sources: IMF and OECD statistics, adapted.

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the Nation. Frustration comes easy in the Congress, and cynicism is never very far behind. But no frustration was ever great enough to lead Joe Martin to cynicism.

The Republican Party is justly proud of Joe Martin, but what is even more important, the country is proud of him, and the better for having had his long and faithful dedication to it.

THE IMPACT OF U.S. CONTROLS ON FOREIGN INVESTMENT

HON. THOMAS B. CURTIS

OF MISSOURI

IN THE HOUSE OF REPRESENTATIVES

Thursday, June 6, 1968

Mr. CURTIS. Mr. Speaker, Mr. John J. Power, Jr., president of Chas. Pfizer & Co., Inc., recently made a speech before the American Management Association on the subject "The Impact of U.S. Controls on Foreign Investment." His analysis is as clear and compelling as any I have yet seen.

Mr. Powers makes the following main points:

First. Between 1950 and 1966 the Government sector has been continuously in deficit in the total amount of \$87.6 billion. During the same period the private sector has been continuously in surplus in the total net amount of \$59 billion. But to cope with its balance-of-payments deficit, the Government is increasingly curtailing private sector investments, not governmental expenditures. Why should the burden fall so heavily on the private sector—the sector largely responsible for the inflow of dollars?

Second. From 1950 to 1966 the return on U.S. direct investments abroad returned more than \$20 billion in dividends, royalties, and fees alone. In addition direct investments encouraged U.S. exports as parents exported to affiliates abroad. But the Government is now curtailing direct investments overseas—thus reducing return on investment and U.S. exports.

Third. The payback period for outflows of U.S. dollars for manufacturing investment abroad is about 2½ years on the average. Every investment curtailed today will hurt the balance of payments in the very near future. The voluntary program begun in 1965 is already now in 1968 curtailing net inflows to the United States from investments that would otherwise have been made in 1965, 1966, and 1967.

Fourth. Direct investment is not an alternative to exports, but rather an absolute necessity to build markets abroad.

Fifth. The mandatory program now in effect introduces distortions into a business and weakens it immediately.

Sixth. The mandatory program upsets foreign governments by showing that the U.S. Government has the right to decide how earnings are to be distributed despite local stockholders, national sensitivities, and efforts on local capital markets.

Seventh. The mandatory program should be continued no longer than 1968. The basic cause of our problem—the ex-

cess of Government outflows over private inflows—must be attacked.

As Mr. Powers concludes:

We must return to a freer flow of investment and trade which, in an era of unrelieved political crisis, has been perhaps our brightest international achievement—and more than that, a necessary basis for ultimate peace in the world.

The speech follows:

THE IMPACT OF U.S. CONTROLS ON FOREIGN INVESTMENT

(A speech by John J. Powers, Jr., at an American Management Association special briefing, New York City, April 10, 1968)

The balance of payments of the United States has been in deficit every year but one since 1950. From 1950 to 1966 the deficits averaged \$1.5 billion. 1957 was a year of surplus. But in 1958 the deficit appeared again and increased substantially, and from that year to the present the deficits have averaged \$2.6 billion. Despite their persistence, there seems to be no general agreement as to the causes nor as to the cures, leaving this important part of our foreign economic policy in a continuing state of uncertainty.

Let us examine for a moment one very important area of disagreement which has persisted throughout the last eight years of debate on this subject. First let us look at the overall picture. Between 1950 and 1966 the United States Government paid out net in military expenditures, grants, loans and for various services \$87.6 billion. During the same period, corporations and private citizens brought into the country \$59.0 billion in excess of all private dollar outflows. In short, during this period the government sector has been continuously in deficit, and the private sector continuously in surplus. But the surplus has not been sufficient to cover the public sector deficit.

The U.S. Government, however, has sought to grapple with the problem not so much by curtailing its own expenditures but by curtailing private sector investments and especially the direct investments of American business in production and marketing facilities abroad. Businessmen have reacted to this policy with astonishment. From their own experience they know that their direct investments have returned substantial income to their companies in the United States, far greater than the direct investment outflows; indeed, that is the whole point of making the investment. And a look at the statistics for all industry confirms the experience of the individual companies. In the overall national accounts, direct investments are seen to be a star performer in the balance of payments, as I am sure most of you have found in your own examination of the record. If then such an examination suggests so clearly that the primary reason for a continuing deficit lies in government disbursements, why is so little done to reduce them?

NATIONAL POLICIES AFFECTED

To begin with, whether and to what extent we can reduce these disbursements present difficult questions affecting basic national policies. And after two decades, vast global commitments have been built into our political system. Though the seeds of crisis have been contained in these policies, the crisis has developed slowly. And now that it is here, our approaches to issues of foreign policy have become ingrained habits, and the budgets involved somewhat sacrosanct. It is true some effort has been made to hold down foreign aid or tie it to U.S. exports, but this has been due to Congressional pressure. Rather than face the disagreeable necessity of revising our commitments further, the whole thrust has been to look for alternatives, for expedients that is, that will permit us to continue the current level of government expenditures. I am not so unrealistic as to suggest the elimination or near elimination of military disbursements and AID programs.

But how much evidence do we have that we have tightened the belt in the management of these huge outflows so as to minimize the heavy burden on our payments position? Why should the emphasis rest so heavily on expedients affecting the private sector, which is to such a large extent responsible for the inflow of dollars? Indeed, in the past several years there have been proposals for or use of expedients such as the interest equalization tax, restriction of bank loans, tourist taxes, reduction of free entry allowances, buy-American purchase policies, import surcharges, border taxes and border tax rebates. There are two expedients in particular upon which special stress has been laid. They are the restriction of direct investments abroad and the strong promotion of exports. These two are related and are the subject of my particular interest in this paper.

WHAT ARE DIRECT INVESTMENTS?

First, direct investments. What do we mean by direct investments? Not portfolio investments nor bank deposits. But rather plant, equipment, inventories, warehouses, accounts receivable, and people, skilled and unskilled, of all colors, religions and languages. Direct investments are prosperous and productive business enterprises providing goods and services, giving employment, upgrading industrial skills, paying taxes, and in many cases giving a major stimulus to industrial and sociological development in a community or even in a nation.

The significance of such investments is now substantial. Since 1950 they have been growing at a rate of 10% per year. The average rate of worldwide growth of GNP is about 5% a year, so that such investments are growing at twice the rate of production. It is estimated that deliveries to markets from the foreign facilities of U.S. companies amount to \$110 billion or about four times the value of exports delivered to those markets (value of exports: 1965, \$26 billion; 1966, \$29 billion). It has been aptly pointed out that U.S. companies are creating a third economy in markets abroad. There is the U.S. domestic economy, the Soviet economy, and next in order of magnitude, U.S. business abroad.

I have already referred to the contribution of direct investments to the balance of payments. It is important to note that from 1950 to 1966 these investments returned in dividends and royalties and fees alone \$20 billion in excess of all outflows. But as every individual company knows, the returns were much greater than this. They included also the net inflows resulting from the trade of parent companies with their affiliates, that is, the surplus of exports to affiliates over imports from affiliates.

In highlighting the contribution of direct investments to the balance of payments, I do not intend to deprecate the importance of exports, or rather what is commonly called the trade surplus, that is, the surplus of exports over imports. I am saying, however, that in order to obtain a just and useful comparison of the relative contributions to the balance of payments of direct investments and the trade surplus, it is necessary to make some key adjustments. We must, as already suggested, reduce the trade surplus by the amount of the net inflow due to trade of parent companies with affiliates, and also it is necessary for fair comparison to eliminate those supported exports which were financed by the U.S. Government, particularly under the AID program.

CONTRASTS IN OFFICIAL POLICIES

Making these adjustments for the years 1964, 1965, and 1966 (the only three consecutive years for which figures are available), we find that the trade surplus for these years cumulatively was \$5.7 billion and the direct investment surplus was \$6.1 billion. There are thus two major contributors to the balance of payments, the trade surplus and the surplus derived from direct investment, but interestingly the public policy towards each of these contributors is not the same as one

might expect, but quite different. Every effort is directed by the government to increasing exports while restrictions are placed on direct investments.

What is the justification for such different treatment of the two star performers? Direct investments, it is now conceded, make a substantial net contribution to the balance of payments, but it is pointed out the inflows in any one year are the result of investments made in earlier years; and similarly, the accumulated inflows are the results of the investments of the years prior to those included in any selected period of years. Looking at the matter from the point of view of the short run then, it is argued that the returns from previous investments can be regarded, so to speak, as vested. Therefore, the argument continues, we can cut down current outflows while still preserving the previous rate of inflows and thus gain a short-term advantage, even admitting there will be a long-term disadvantage.

PAYBACK ON DIRECT INVESTMENTS

But what is the short term? There has been much discussion on this point since this rationale of restriction of direct investment was first advanced some seven years ago. Recently, Professor Behrman argued before the Joint Economic Committee that the payback period for outflows of U.S. dollars for manufacturing investment abroad is about 2½ years on the average. If this is right—and I must say, this estimate comes close to my own experience—this is a very short term indeed. In fact, 2½ years have already elapsed since the Voluntary Program was first introduced as an emergency measure. By now, therefore, we are experiencing a loss as a result of many investments that were not made and which would now be returning net inflows to the United States.

Isn't the short term too short to justify this course? And beyond that, is there really such a clearcut advantage in the short term when we restrict direct investments? There are two distinct approaches to this last question. The economist who often has the ear of government tends to apply a marginal analysis, thinking in terms of an additional increment of investment outflow and the returns to be ascribed to that additional increment. He tends to think of a new project more as if it were merely an investment than part of a gradually growing and developing business organism. He asks what is the rate of return, with the implication that investments will always seek the highest rate of return at any moment in time, regardless of other factors. The businessman, on the other hand, asks what is the market opportunity. Above and beyond the rate of return or payback on a single project he asks what is the relation of the investment to the whole operation. In short, he makes a basic judgment as to the potential of the market and the need, for example, to move now to establish, expand or protect market position. The economist sees restriction on direct investment as yielding a statistical advantage in the short run. The businessman sees it as an immediate infringement on the effectiveness of a going business operation resulting not later but now in loss of market share, financial strength or such intangibles as morale of personnel.

GOVERNMENT EXPORT PROMOTIONS

I will come back later to this question of the short and long run in connection with the discussion of the Mandatory Program. Meanwhile, it is important to say a word about the other expedient for improving the balance of payments which is of special significance to business, namely government promotion of exports. For years, successive administrations have exhorted businessmen to export and save the country. These exhortations are being heard again. They have not brought substantial results in the past. They will not now, because government export promotion programs are founded on an

illusion—the illusion that American international business is still what is used to be 30 years ago—largely a matter of swapping exports and imports. While the textbooks on international economics still labor to expound in great detail the nature and causes of trade, the world has moved on.

It is simply not possible in this decade of the 20th Century to establish a business effectively in most world markets in most products by exporting. I say most markets and most products because there are always some exceptions. By constant stress on exports, we perhaps obscure the facts of life of business abroad, or more specifically, the fact that successful market penetration usually requires building warehouse, creating and training and organization; it requires local sales promotion, and very likely, in the end building plants or assembly lines to back up the marketing effort; in short, it requires direct investment.

DIRECT INVESTMENT A MUST

To those who argue that direct investment is an alternative to exports, or that the process damages our international position because it involves export substitution, I would say that we would like nothing better than to sit in New York and manage an export operation. How very much simpler it would be to do that than to put down roots abroad, establish local organizations, build plants, negotiate with governments, and manage assets in foreign countries. Why don't we do it? Are we wrong? Is this a vast management error? I do not think so. We have not gone the exporting route because we can't get the business that way. Wherever we put a plant, where before we were exporting, it is because it was necessary to maintain and expand our business. If we had not done it in most cases, we would have lost the exports anyway and not gained more business through local production and distribution.

As Mr. Charles Stewart of the Machinery and Allied Products Institute recently pointed out so well, there is one central fact about international business that cannot be ignored, neither by an individual company nor by government. To obtain, hold and improve market position abroad requires an integrated approach in terms of direct investment in local plants, exports, licensing, and so on, operating throughout the world, in both developed and developing countries.

CENTRAL POLICY ERROR

The central error of current policy is the effort to segment and splinter international business operations—approving exports, discouraging direct investments, varying the permitted outflows and the required inflows between groups of countries, and to apply these highly distorting and detailed controls to the delicate structure of international trade and investment in the belief that the effects will be temporary and that there will not be serious economic and political repercussions.

Now—what of the Mandatory Program? What can we say of a more specific nature about it? With this program we have moved into a new phase in the process of increasing restriction, it is no longer a question of holding down outflows and bringing back earnings to the extent possible while maintaining the health of the business and the necessary momentum of growth. In Western Europe, the Mandatory Program requires that many companies actually remove from their overseas businesses, earnings required for their health and growth.

Most companies seem to pay out in dividends in the neighborhood of 50% of their earnings so that it would not be unreasonable to insist on the return of earnings to the United States of this amount or even somewhat more, at least for companies that are relatively mature in international business. Certainly in this emergency, no company should be allowed to hold dividends back in order to earn interest abroad. As it

is, however, many companies will be obliged to borrow solely in order to fulfill the requirements to remit a proportion of earnings, in many cases over 90% from Schedule C countries. And some will have to borrow again in order to repay the loan. And the introduction of such distortions into a business is not in the future. The business is weakened immediately—in the short run. It is surprising that it is difficult to convince some of this fact, though I suspect if the larger companies of the United States were asked to withdraw from operations 90% of their United States earnings this year, there would be a tremendous outcry, and the charge would rightly be made that we were drastically distorting the structure of the economy. By the same token, we are distorting by the current Mandatory Program the structure of that important third economy, American business abroad.

"SEED CORN" PARALLEL

There is no doubt that every businessman would wish to cooperate with the Administration in a short-term emergency. It is always possible to conduct an "efficiency campaign" in business, to squeeze for a while, cut costs, postpone some investments in order to provide larger immediate returns, all on the assumption that other measures will be taken promptly in the time thus bought, to permit the momentum of the business to be resumed before opportunities are lost or competition moves ahead. But we cannot forget that in restraining direct investment we are economizing on seed corn. I suppose one could conceive of circumstances severe enough to warrant eating some of the seed corn. But obviously the emergency must be both serious and brief, and it is crucial that effective plans for finally correcting the imbalance in our payments position meanwhile be implemented.

Though various programs have been initiated in the past seven years, they have focused on temporary benefits, ignored root causes, and therefore have not been effective. Once again in the Mandatory Program, attention is focused on temporary improvements in order to buy time. The alarming thing is that, as you remember, this same approach has been used in various ways since 1961. (At that time, the official view was that equilibrium would be reached in 1963). In 1965, in 1966, in 1967, and now in 1968 with the tightening of restrictions over direct investment, we have had a repetition of assurances that each new stage was only temporary. It is surely relevant to ask, however, after seven years, what have we bought with these repeated short-term measures? And to question whether present policy has the elements to correct the basic problem of the deficit.

Since the regulations were announced, companies have been bombarded with inquiries as to how the regulations are affecting them and will affect them and, as you all well know, it has been difficult to give a precise answer. For one thing, we have had to spend many man hours examining the regulations and interpreting them with respect to our business. After three months, it is still difficult to be precise about the impact of the program. It appears that the policy is to grant few or no exemptions until a company has proved it cannot make available funds from any other part of its worldwide operations and has exhausted all its borrowing resources. Relief, it seems, will only be granted when credit can no longer be obtained. I say that it is difficult to be precise about the impact of the regulations on the operations of the company, but perhaps that was not quite an accurate statement because this policy in effect seems to suggest that a company will get relief only when it is in serious financial condition.

The regulations in short will be forcing it to expand its borrowings to the limit of its credit and then it must hope and trust it can secure the necessary relief to permit its grave

financial position to be alleviated. It is not necessary to underline before an audience of this kind the difficulties and dangers of making any plans under such conditions. Moreover, it would appear that in many cases it is not so much an exemption that is granted, as a delay, with the understanding that anything conceded must be returned in the near future. On these points, we will probably be able to speak with more certainty as patterns of decisions begin to emerge from the Office of Foreign Direct Investments.

OTHER IMPACTS ASSESSED

There are other impacts of the program. There is no doubt, for example, that to a significant degree, though difficult to measure, companies with little or no current activity abroad have been discouraged or prevented from taking advantage of rapidly growing world markets, with permanent effects on the competitive position of the United States in those markets and permanent losses to the balance of payments. There is another impact also of great significance. I have in mind the effect of the program on the relations of U.S. companies with local governments and communities and their efforts to be accepted as corporate citizens seeking to serve the interests of the country of which they are residents. It has not always been easy, but most U.S. companies abroad have won a high degree of local acceptance because they have become sensitive, if they were not so at the outset, to the policies and attitudes of host countries.

The Voluntary Program to a degree, and the Mandatory Program decisively, cry to the high heavens that such companies are in fact American companies and that the U.S. Government has the right to reach in and direct how the earnings are to be distributed despite local stockholders, despite national sensitivities and in Europe, despite the secondary effects on local capital markets. At a time of rising nationalism these programs unfortunately confirm the worst fears of the host country that the affiliates of U.S. companies are in fact aliens in the national economy, subject to laws and regulations of a foreign state. I would predict that this new and radical extraterritorial claim will cause reactions and affect our operations abroad for years to come.

FUTURE DIRECT INVESTMENTS POLICY

What then should be the policy towards direct investments? The logic of the matter seems clear. In the relatively short period since the early 1950's, U.S. international business has built up dollar-earning assets which have become the major contributor to our balance of payments. Why not continue the process? It is working. It will continue to work if we do not ourselves kill it. It has been argued that all segments of the economy must make a sacrifice in the common cause and that therefore the private sector, far from expanding its operations abroad, must also take a cut. But such an argument makes no sense if the cut is counter-productive, if the so-called sacrifice is, in fact, a sacrifice of the end we are seeking, namely, an improvement in the balance of payments. And, unhesitatingly, I say that it is on this point that I rest my case.

As to the Mandatory Program, I can see no basis for continuing it beyond 1968, and its administration in the remaining months of this year should be on a more flexible and realistic basis, obtaining whatever belt-tightening gains there may be in it without diminishing valuable American assets abroad. Most important, we must attack the basic causes of our problem, and I mean the excess of government outflows over private inflows, and also, though time does not permit more than a mention of it here, bring about changes in our international monetary system that would improve the overall adjustment process.

DANGERS OF INDIFFERENCE

I recognize that most of those present at this meeting are concerned with the problem of interpreting the regulations, seeking relief, if possible, and bringing about the best possible adaptation of the company to the hard circumstances imposed upon it. This, of course, is an important objective. At the same time, we cannot be indifferent to the longer term problem of bringing about a change in the policy. It is difficult for business leaders to criticize government policy at a time of emergency and run the risk of appearing unpatriotic. And yet we must speak the truth of the matter as we see it. Certainly, if we do not discuss these crucial issues in terms of our experience and discuss them publicly, then we cannot expect our views to be considered in the making of policy. The fact is, these are complex matters, and no one has a monopoly on economic wisdom with respect to them.

Businessmen must continue, therefore, day in and day out, to explain their operations abroad and relate them to major current issues such as the balance of payments and world economic growth and development. They must, at the very least, urge on the United States Government, policies that make economic sense, that harness the dollar-earning power of business operations abroad to the needs of U.S. foreign policy, without weakening those operations. They must reassert the priority, now being lost, of the freer flow of investment and trade which, in an era of unrelieved political crisis, has been perhaps our brightest international achievement—and more than that, a necessary basis for ultimate peace in the world.

THE SUGARCANE FARMERS' PLIGHT

HON. JOHN R. RARICK

OF LOUISIANA

IN THE HOUSE OF REPRESENTATIVES

Thursday, June 6, 1968

Mr. RARICK. Mr. Speaker, the American cane farmers—like many other agricultural producers—face a serious financial crisis as a result of a nonflexible, controlled production quota.

They are a part of the U.S. economy—their dollars stay in our country. Their crisis is our problem—they seek relief—we must come to their aid.

I include the statement of Mr. William S. Chadwick of New Orleans, La., given before an informal meeting of the House Agriculture Committee and interested parties in full text:

STATEMENT OF WILLIAM S. CHADWICK, REPRESENTING LOUISIANA AND FLORIDA SUGAR CANE FARMERS AND PROCESSORS, INFORMAL AGRICULTURE COMMITTEE MEETING, HOUSE OF REPRESENTATIVES, MAY 14, 1968

Mr. Chairman and members of the committee: My name is William S. Chadwick. I reside at New Orleans, Louisiana, and I am President of Southdown, Inc., a sugar cane farmer and processor of the Mainland Cane Sugar Area. I appear here today as a representative of all of the approximate 5,000 sugar cane farmers and the 49 sugar cane processors of the State of Louisiana and the State of Florida, who collectively comprise what is designated in the Sugar Act of 1948 as the Mainland Cane Sugar Area.

We are deeply appreciative of this opportunity you have granted us to appear before you in this informal meeting and explain, to the best of our ability, the critical situation that faces our sugar cane farmers and processors

today. We believe after listening to the facts of our case you will realize our plight is, indeed, a serious one, that there is great merit to our cause, and that remedial action would be fair, equitable and proper and, moreover, should undoubtedly be taken quickly.

The facts are simple. All other domestic sugar producing areas, both cane and beet, are operating today completely without acreage restrictions. The sugar cane farmers of the Mainland Cane Sugar Area have meticulously complied with all of the acreage restrictions and requirements imposed under the Sugar Act of 1948. Nevertheless, the inventories of sugar in our Mainland Cane Sugar Area have increased to the point where it is presently contemplated that a 22.5% acreage reduction will be imposed for the 1969 crop. This reduction will be on top of two reductions already imposed since 1964 which aggregated approximately 15%, or a total average cumulative reduction beginning in 1969 of about 35%. Some farmers would suffer a reduction as high as 40%.

The prospective 1969 acreage reduction of an additional 22.5%, in the absence of remedial legislation, is not a figment of our imagination nor is it an exaggerated prediction with a self-serving purpose. You will find attached to my prepared statement, as "Exhibit A", a copy of a letter dated April 16, 1968 from Mr. Tom O. Murphy, Director, Sugar Policy Staff, A.S.C.S., United States Department of Agriculture, addressed to Honorable Edwin E. Willis, Congressman from the Third Louisiana District. It is the Director of the Sugar Policy Staff, who states, based upon the assumptions contained in his letter, that an additional 22.5% reduction can be expected in the Mainland Cane Sugar Area for the 1969 crop.

At this point let me say to you, so that we will be ever mindful, that for the most part our sugar cane farmers are engaged in one-crop agriculture. They have no profitable substitute crop to which they can turn. Their sugar cane crops, planted at substantial costs, represent at least a three year investment. Their expensive, highly specialized machinery and equipment has no other use.

It is very pertinent that we closely examine the conception, birth and growth of our problem in order to understand why and how this problem developed. Such examination and understanding is critical to your final conclusions. They will indicate that our present excessive inventories of sugar did not result from any farmer exceeding his production quota, nor did they result from any action by the Mainland Cane Area farmers or processors in prevailing upon the Secretary of Agriculture to temporarily remove production quotas. We particularly desire to negate any statement or implication that we are endeavoring to have the Congress extricate us from a position of peril that we brought upon ourselves. Nothing could be further from the truth.

The records of the Department of Agriculture will show that every pound of the sugar comprising our excessive inventory was produced from sugar cane grown on acreage authorized in conformity with the provisions of the Sugar Act and the restrictive regulations and orders issued thereunder.

On May 17, 1963 because of the threatened world shortage of sugar and spiraling sugar prices, the Department of Agriculture announced that the maximum production of sugar in the United States was needed, and that no acreage restrictions would apply to the 1964 crop in our area. We do not desire to be critical of the Department and realize the tremendous pressure on it brought about by the prospects of a sugar shortage. The Department has had a very difficult job, and in most instances should be highly commended. However, in self-defense, let us point

D. Webster

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**OVERSEAS
MANUFACTURING
INVESTMENT AND
THE BALANCE
OF PAYMENTS**

U.S. TREASURY DEPARTMENT, Washington, D.C.