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CLIFFORD J. HYNNING

Balance-of-Payments Controls by the United States

The United States successfully fought World War II by fielding the largest overseas military forces in the history of the world, supplied and equipped its military allies in Europe, Africa, Asia, throughout the Pacific and in the Western Hemisphere, underwrote almost three-fourths of UNRAA, provided interim aid to Europe, and at the beginning of the Marshall Plan (1948) held gold in excess of $24 billions. As of March 1, 1968, U.S. gold holdings had fallen by more than half, or now amount to $10.9 billions. During this same period the gold holdings of France, Germany, and Italy increased from .8 billion in 1949 to 11.9 billion by the end of 1967. (See Chart I.)

Since the 1944 Breton Woods Conference the United States has stood foremost among the financial powers of the world in opposing exchange controls and in championing the international flow of capital and trade without nationalistic restrictions. The exchange controls historically employed by the United States have been strictly for waging war against acknowledged enemies by blocking and vesting property of enemy taint, as the United States did during World War II when it imposed freezing controls in 1940 against Germany and the countries overrun by Nazi Germany [1] and again against North Korea, Communist China, Cuba, and North Vietnam.[2] Such exchange controls against transactions with or on behalf of recognized enemies were appropriately taken under Section 5(b) of the Trading-With-the-Enemy Act, as amended.[3]

On January 1, 1968, this historical position of the United States against exchange controls was radically altered in a sobering

[1] E.O. 8389, as amended, 12 U.S.C.A. 95a at pp. 456-59.

[2] 31 CFR 500.201 and 31 CFR 515.201.

[3] 12 U.S.C. 95a and 50 War App. 5. Both citations contain the text of § 5(b).

New Year's message to the American people by President Lyndon B. Johnson, who that day had signed Executive Order 11387 [4] controlling under Section 5(b) of the Trading-With-the-Enemy Act foreign direct investments by American capital in friendly countries, *infra,* pp. 429-436. On the same day the Secretary of Commerce, to whom the President had delegated many of his extraordinary powers under Section 5(b), issued Part 1000 of Title 15 of the Code of Federal Regulations, entitled Foreign Direct Investment Regulations (hereinafter called the "FDIR").[5] Ever since these controls were made public on the first of January, 1968, it has become necessary for U.S. business men investing or even trading abroad to ask their lawyers what they can do under the burgeoning FDIR which are rapidly imitating the mercantilist controls of the *ancien régime* of Bourbon France and the cameralist system of 18th century Prussia.

How has such a reversal in financial policy come to pass?

I. The Origins of the Balance-of-Payments Problem of the United States

During the past decade the balance of payments of the United States has become of mounting concern to the Government, to the world financial community, and to increasing sectors of the American people. U.S. holdings of gold have been declining at such a precipitous rate—more than $1½ billion in 1967—that it has become unfortunately commonplace that many foreigners now daily question the stability of the dollar as an international medium of exchange. Forefront in the attack on the dollar has been Gaullist France, which has consistently over the past few years demanded the instant conversion of its dollar earnings into gold.[6]

[4] 33 F.R. 47-48.

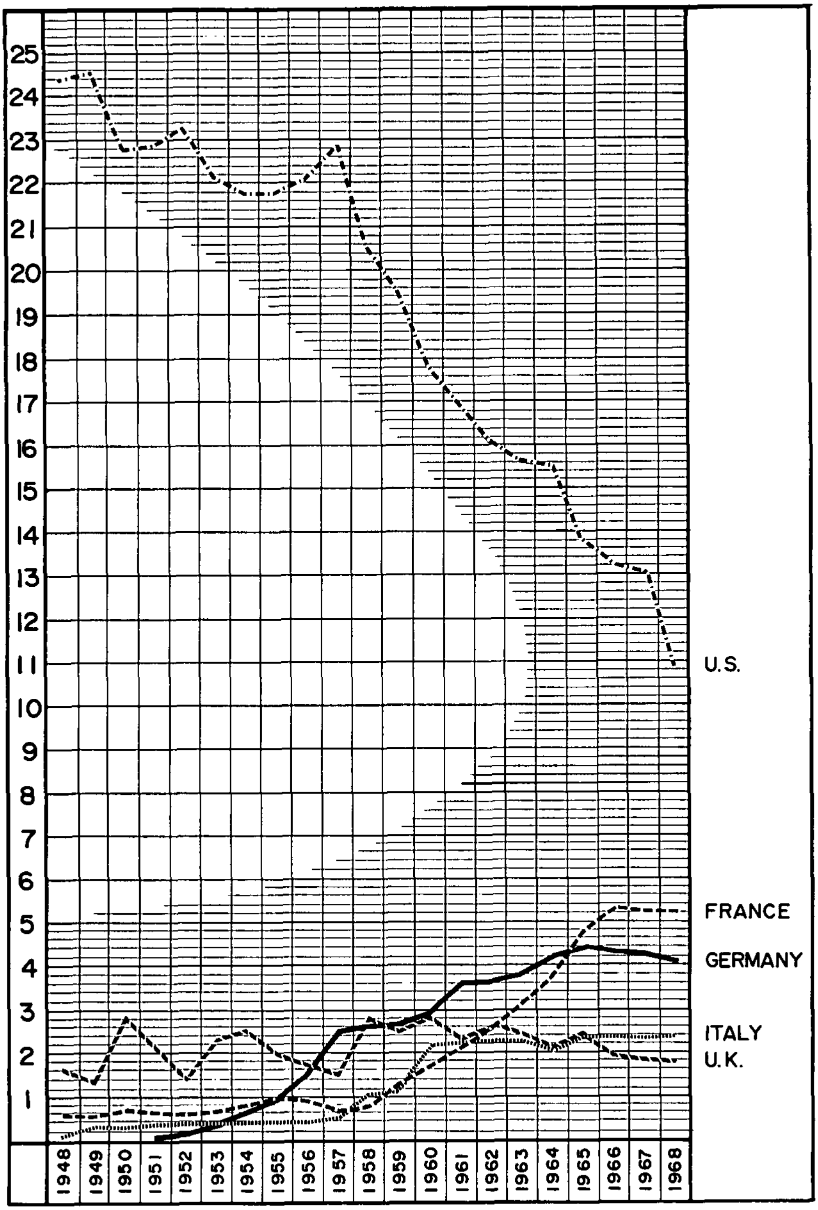
[5] 33 F.R. 49-53, as amended Jan. 22, 1968, 33 F.R. (No. 15).

[6] Parenthetically, one should note the interesting fact that the Sino-Soviet countries have little questioned the dollar, which they constantly employ as the most appropriate standard for measuring international obligations of trade and assistance among themselves and with other countries in Europe, Asia, and Africa.

The London *Economist* noted that "China did not join in the two big gold rushes last November and December . . . [and] in the recent, post-devaluation stampede . . . China stood aside. . . . All of which could indicate that Chairman Mao has recently had greater faith in the dollar and the western currency structure than a lot of other, more nervous people around the world." (February 24, 1968, p. 75.)

CHART I

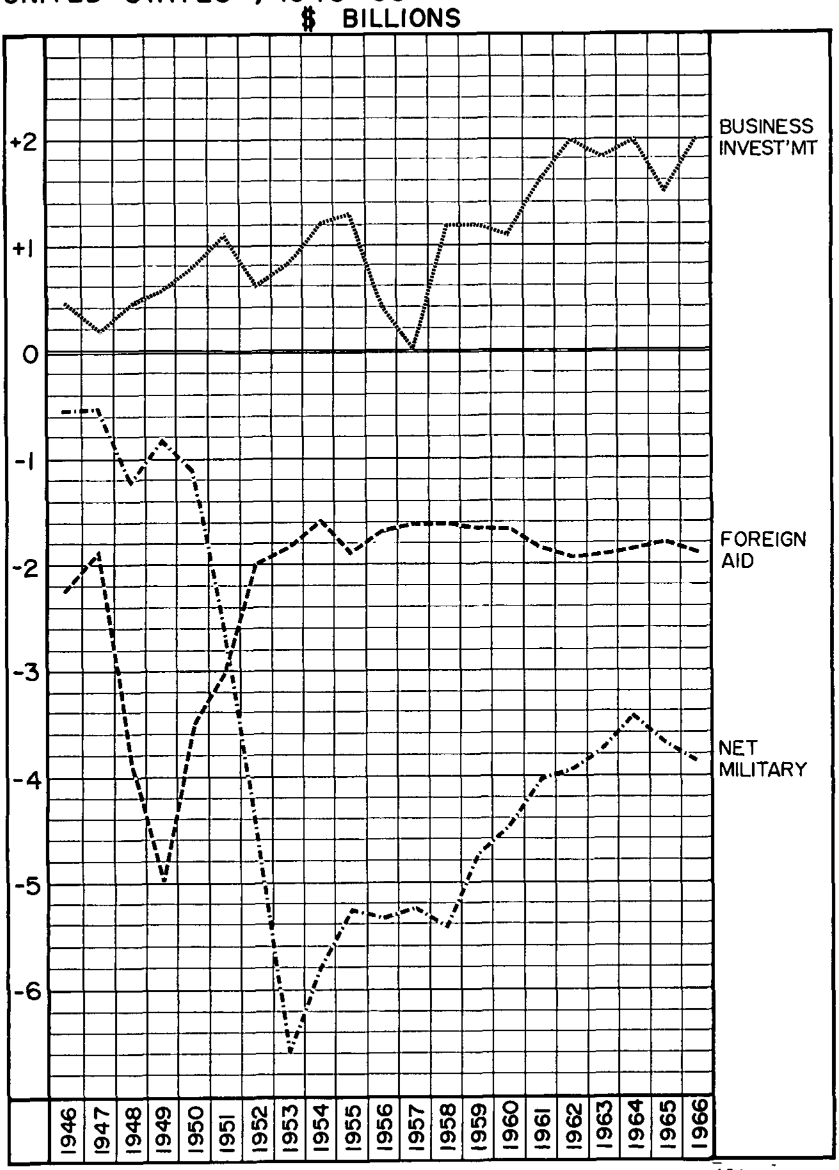
GOLD RESERVES OF FRANCE, GERMANY, ITALY, UNITED KINGDOM & UNITED STATES, 1948-68
$ BILLIONS



SOURCE: INTERNATIONAL MONETARY FUND, INTERNATIONAL FINANCIAL STATISTICS

CHART II

IMPACT OF FOREIGN BUSINESS INVESTMENTS, FOREIGN AID & THE MILITARY ON THE BALANCE OF PAYMENTS OF THE UNITED STATES, 1946-66



SOURCE: FOREIGN BUSINESS INVESTMENT, 1950-66 TAKEN FROM TABLE-I P 406
ALL OTHER FIGURES FROM U.S. DEPT. OF COMMERCE, SURVEY OF CURRENT BUSINESS. THE MILITARY FIGURES HAVE BEEN REDUCED BY CASH SALES OF MILITARY EQUIPTMENT

The balance-of-payments crisis of the United States is indeed unique in the annals of international finance. Such a crisis usually means that a country's production and export trade are not keeping pace with those of its principal commercial competitors and that if these conditions continue, its currency and its reserves may be in danger. The former is obviously not the case of the United States—production, industrial and agricultural, and export trade have been constantly rising during the sixties. U.S. prices are competitive with those of other countries. In fact, during recent years the prices of many European competitors have been rising in comparison.[7] The question remains unanswered: Why must the United States, functioning at peak economic efficiency, worry over its balance of payments?

Yet plainly, the United States has experienced a dramatic loss of gold—reserves are lower than they have been since the thirties and are less than half of what they were at the beginning of the Marshall Plan. Technically, the loss of gold has come about by virtue of (a) the policy of the United States to buy and sell gold to foreign monetary authorities at $35 an ounce plus the transfer points, and (b) the increasing tendency of foreign holders of dollars to convert to gold. These gold losses have occurred even though gold itself is a wholly unproductive commodity, earning no income and costing much to move and to hold. How then did the foreign buyers of our gold get the dollars which they apparently do not require for more productive purposes?

The Government's Case: Foreign Investments and Tourism

Excessive lending and investment abroad by American banks and business enterprise[8] and the explosion of American tourism

[7] The Treasury's recent study, *Maintaining the Strength of the United States Dollar in a Strong Free World Economy* (1968), shows at p. 69 (multilith edition) that the United States "had for five years an unprecedented degree of stability in the U.S. in industrial prices, while creeping inflation was going on in the rest of the world. . . . Along with that price stability we had an unprecedentedly long period of uninterrupted economic growth. . . ." The Treasury also found that "in the 1960's, U.S. unit labor costs in manufacturing declined slightly while those of our major European competitors rose significantly" (at p. 79). But "in 1966 and probably in 1967, the U.S. competitive position was eroded by increases in U.S. labor costs" (at p. 80).

[8] Thus the Treasury reported, "The favorable trend in the balance on goods and services from 1960 to 1964 was offset, however, by a strong tendency for private capital outflow to increase" (*op. cit.,* n. 7, at p. 69).

abroad[9] are the common answers of the U.S. Government. Foreign monetary critics who decry the spread of American investment throughout the world agree on the first.

Is there a demonstrable case for this view that a major cause for the U.S. balance-of-payments crisis is private lending and investment abroad? Obviously, any bank which lends money abroad or any business enterprise which makes capital investments abroad is by definition making a negative contribution to the balance of payments of the United States—that is, the outflow of loan and investment funds from the United States to foreign investment adds that much to the deficit in the balance of payments. But that definitional answer fails to take into account the inflow of dividends, interest, royalties, and fees received on private investments abroad. And that answer overlooks the close relationship of investment abroad to export trade. It is only a small chapter in the story if we look at the capital outflow alone. When we add up the investment income received by the United States from investment abroad, deduct the investment income paid out to foreigners on their investments in the United States, and deduct the current capital outflow, we do not find figures to support a conclusion for reducing United States investment abroad for balance-of-payments reasons. Table I, prepared by the U.S. Treasury, shows the net impact of international investment on the balance of payments. Continued reliance on restrictions of capital outflow for private investment abroad, which have invariably been productive of greater future earnings, is a short-term situation and indeed slays the goose that lays the golden egg. This is so, even though that is what de Gaulle would like to see, so long as it is the American goose without any competitive *paté de fois gras.*

What Chart II Shows: Foreign Aid and Military Operations Abroad

Where then does this continuing balance-of-payments deficit come from? Chart II shows that the operations of the United States Government, not private investment, are the principal factors pro-

The Treasury's own figures, however, showed as Chart II does, that inflow of investment income rose along with the capital outflow, with the result of a net impact of investment on the balance of payments.

[9] The Treasury reported that "the travel deficit increased from approximately $1.2 billion to $1.6 billion" during the period 1960-1966 (*op. cit.*, n. 7, p. 138).

TABLE I

U.S. DIRECT INVESTMENT ABROAD

($ million)

	Book Value	Outflow from U.S.	Earnings Remitted to U.S.	Royalties and fes	Yield [a]	Net Balance of Payments Impact ($ Billion)
1950	11,788	621	1,294	126	17.7	0.8
1951	12,979	508	1,492	129	20.1	1.1
1952	14,721	852	1,419	130	18.9	0.6
1953	16,253	735	1,442	128	16.2	0.8
1954	17,631	667	1,725	136	15.6	1.2
1955	19,395	823	1,912	158	17.2	1.3
1956	22,505	1,951	2,171	229	18.2	0.4
1957	25,394	2,442	2,249	238	16.9	—
1958	27,409	1,181	2,121	246	12.8	1.2
1959	29,827	1,372	2,228	348	13.1	1.2
1960	31,815	1,674	2,355	403	13.3	1.1
1961	34,667	1,599	2,768	463	13.4	1.6
1962	37,226	1,654	3,044	580	13.9	2.0
1963	40,686	1,976	3,129	660	14.1	1.8
1964	44,384	2,435	3,674	756	14.3	2.0
1965	49,328	3,418 [a]	3,963	924	14.4	1.5
1966	54,562	3,543 [a]	4,045	1,045	13.6	2.0

[a] Includes use ($52 million in 1965 and $445 million in 1966) of proceeds from bond issues abroad by domestic-based finance subsidiaries of U.S. firms.

Source: U.S. Treasury Department, *Maintaining the Strength of the United States Dollar in a Strong Free World Economy* (1968), Table 15 (p. 120), Tab D, Table 2.

ducing over several decades the deficit in our balance of payments. Is the quick answer also the correct answer?

The explanation for this radical change in the American balance-of-payments position may be found in several serious errors in financial judgment by economists who were advising the Secretary of State, the Secretary of Treasury, the foreign-aid administrator, whatever his title, and the Council of Economic Advisers over the past several decades on international financial and monetary policies of the United States. The present predicament is also due in substantial measure to 190° changes in the financial methods of handling foreign military operations. Gone are the days of lend-lease, when the United States equipped the greatest military forces in foreign lands without providing currencies to its allies or aiding them in building up their gold reserves.

Was It a Fatal Error in Judgment to Make Too Many Grants and Too Little Repayable Loans Under the Foreign Aid Programs?

At the time of the inauguration of the Marshall Plan in 1948, both the Executive and the Congress were greatly concerned lest the foreign aid programs build up foreign monetary reserves by the aid recipients which would adversely affect United States finances [10]

[10] See Report of the National Advisory Council of International Financial and Monetary Problems (hereinafter called NAC) to the 80th Congress, 2nd Session, H. Doc. 737, pp. 19-23.

and thereby threaten the only stable currency in the post-war world. The principle of aid in kind (raw materials and equipment), as against aid in gold or money, had guided United States financial policy throughout World War II and in the years immediately thereafter. With the worsening of economic conditions in Europe and throughout the rest of the world, great pressures operated on the United States to provide aid for the rebuilding of war-torn economies and to do so on a grant basis rather than in loans. In the first year of the Marshall Plan, the Congress, principally at the insistence of the late Senator Harry Byrd, required that at least one billion dollars of the annual aid program of $4½ billion should be used exclusively on a loan basis or used in guaranties of private investment. The U.S. Treasury must today deeply regret that the Marshall Plan loans were made in that precise amount and no more.[11] All the other aid funds which could have been extended on either a grant or a loan basis were made available largely on a grant basis.

The reason for this shortsighted decision against loans and in favor of grants in the European Recovery Program (ERP) was that the economists administering the program had so little confidence in the success of their plans for European recovery that they fully expected European trade and finance to continue indefinitely in a deficit relationship to the United States. To some economists the "dollar gap" was a permanent problem. Hence they did not want to add to the problem of European reconstruction by saddling France, Italy, Germany, and the United Kingdom with debts owing to the United States.

The aversion of the economists to inter-governmental loans was a lesson that they thought they learned decisively from World War I debts and the insoluble transfer problem of the twenties that led to the collapse of European economies in the thirties, a collapse culminating in the famous Hoover Moratorium which suspended payment on World War I debts by most European countries to the United States.[12] The economists contended that the way to avoid the prob-

[11] Loans were actually held to $972 millions. The interest rate was 2½%, with a waiver of all interest for the period until June 30, 1952, the term was typically 35 years, with no amortization until June 30, 1952, or, in some cases, June 30, 1956. See Report for NAC for the period April 1, to September 30, 1948, pp. 18-19.

[12] With the exception of Finland, the World War I debts of Europe to the United States have not been serviced since the Hoover Moratorium which

lem of debt repayment and negotiations over defaults was not to have any debts at all. Thus there could be no debts to be suspended or forgiven. The forgiveness of debts, the economists believed, presented some constitutional difficulties in the absence of Congressional authorization. If, however, the Executive could provide aid on a give-away basis, thus creating no debt, it would be unnecessary later to go to Congress for authority to suspend or adjust debts. This reasoning lay behind most of the foreign aid decisions on a grant basis for the next decade.

The official formulation of the foreign aid loan policy by the National Advisory Council on International Financial and Monetary Problems at its inception was as follows:

> *Loan Policy*
>
> Certain European countries have accumulated a substantial indebtedness to the United States, including debts arising from war account settlements, postwar credits, and loans extended by ECA during its first year of operations. A further large mortgage upon future dollar receipts would in all probability be a deterrent to the objectives of the recovery program. The imposition of further claims against European dollar earnings by the United States Government would lead to a smaller margin of flexibility in the international accounts of the debtor countries, thereby necessitating disproportionate adjustments in vital imports as earnings fluctuate. The probable effect would

did not cancel but only suspended the payment of the debts. France and others have declined to resume service on the debts. The Executive has recently been loathe to press collection. Efforts are pending in Congress to press for collection.

In view of the long history of nonpayment and the persistent doubts among Executive agencies as to the collectability of the debts, it is unlikely that a general exhortation by the Congress to the Executive to press France for payment of its World War I debts will produce anything. However, if the Congress were to direct the Executive to submit the issue of France's legal liability for its World War I debts to the International Court of Justice, the issue could be finally resolved by an independent tribunal. True, France could avail itself of the Connolly Reservation by the United States, and claim that the war debt issue was one of its own domestic jurisdiction, as determined by France, whereupon the ICJ would lose jurisdiction. But then France, which prides itself on its logicality, would necessarily abandon the argument that the war debts were interdependent with German reparations payments, for no such argument would be available if the issue were exclusively one of domestic jurisdiction.

The vast increases of the gold reserves of both Germany and France would appear to destroy the historic argument against payment of World War I debts and reparations, for such debts to the United States could obviously be paid without now creating an insoluble "transfer" problem. Both countries have the gold!

be to reduce to a corresponding extent the capacity of participating countries to service additional financing which they may require and to pay earnings on direct investments. Therefore, any substantial increases in dollar service charges resulting from the assumption of increased obligations to the United States Government would be scrutinized with particular concern by international lending agencies and private investors.

The Council consequently recommended that the Administrator for Economic Cooperation be authorized, in consultation with the Council, to determine when aid for the fiscal year 1949-50 should be on a loan basis and in what amount. Prudent use of this discretionary power would keep the field open for long-range investment prospects for private capital, for Export-Import Bank financing, and for International Bank loans.

Foreign gold and dollar balances

Prior to the start of ERP, many nations throughout western Europe had drawn down their gold and dollar reserves in order to purchase essential goods from the United States. When the recovery program began, consideration was given to the problem of whether further reduction in such reserves should be made a requisite to receiving continued United States assistance. The Council considered that such depletion of reserves should not be required, but that ECA allocations should not be made for the specific purpose of building up foreign-exchange reserves.[13]

In the second year of the Marshall Plan the Executive sought complete discretion over the allocation of foreign aid between loans and grants. The authorizing legislation accorded this discretion, but the Appropriations Act provided that $150 million could only be made available on credit terms.[14] By early 1950 the economists noted a "marked reversal of the postwar trend" of European reserves, but still clung persistently to the policy that foreign aid "should be predominantly on a grant basis." [15] Even when the United States experienced a net outward movement of gold of $1 billion, and the foreign accumulation of gold and dollar reserves for the first 9 months of 1950 was at an annual rate of $3.7 billion,[16] the economists still

[13] Report of NAC for the period October 1, 1948, to March 31, 1949.

[14] Report of NAC for the period April 1, 1949, to September 30, 1949.

[15] Report of NAC for the period October 1, 1949, to March 31, 1950, pp. 8 and 12.

[16] Report of NAC for the period April 1, 1950, to September 30, 1950, p. 9.

adhered to the view that it would be "unwise to extend any substantial amount of loans in the immediate future." [17]

Foreign reserves of gold and dollars continued to rise by another billion in the six month period from October 1, 1950, to March 31, 1951, ECA aid was suspended to major European countries, but a new form of assistance took its place—military aid for NATO, *infra,* p. 416. Looking at the past policy of foreign aid, the National Advisory Council commented with obvious self-satisfaction:

> The inception of the European Recovery Program in April, 1948, worked a shift in emphasis of U.S. Government foreign aid from loans to grants, and this trend has continued up to the present. Thus grant programs account for approximately 2.1 billion dollars, or nearly 90% of total foreign assistance utilized in the period under review.[18]

As to the future, the NAC repeated its policy against loans as follows:

> For the fiscal year 1952, the Council recommended that extraordinary economic assistance to participating countries should be on a grant basis and that military assistance should be provided on a grant basis or against cash payment, and not on a loan basis.[19]

The new criterion was no longer the size of reserves or the volume of trade or the amount of debt of the aid recipients, but a new formula:

> The Council agreed that, under current conditions, United States foreign assistance should be dictated primarily by considerations of mutual defense. Economic assistance on a grant basis should not be extended for the purpose of increasing gold and dollar reserves, nor should countries participating in the defense effort be required to reduce their present level of reserves as a prerequisite for receiving United States aid.
>
> Economic assistance to underdeveloped areas is ordinarily not extended to meet balance of payments deficits, but rather to provide technical assistance and to increase real resources available for development purposes, and is not expected materially to affect dollar reserves.[20]

As the reserves of European countries continued to rise, the

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[17] *Ibid.*, p. 13.
[18] Report of NAC for the period October 1, 1950, to March 31, 1951, p. 6.
[19] *Ibid*, p. 9.
[20] *Ibid.*, pp. 9-10.

NAC changed the formulation slightly, but the policy continued to be the same:

> The Council concluded, however, that where a country is making satisfactory contribution to mutual defense, an unanticipated accumulation of reserves resulting from the vigorous application of appropriate economic and financial policies should not automatically result in a reduction of aid.* * * The Council strongly reaffirmed its view that extraordinary economic assistance to ERP countries should be provided on a grant basis.[21]

Again that view was reaffirmed as to the mutual security program, in which loans should be used only to the extent specifically required by the Congress.[22]

What happened, however, was that Europe did recover, and spectacularly, especially after its own currency reforms and devaluations, and that the French franc, the German mark, and the Italian lira became much desired currencies. French and German gold reserves have been soaring while those of the United States have been tumbling down because European holders of dollars prefer gold to dollars. (See Chart I.)

If instead of largely forgotten grants—and the total grants by the United States to France aggregate $7½ billion—we now had some Marshall Plan loans repayable by France with her excellent gold and reserves, all of the current gold problems of the United States, resulting from French demands for gold, would vanish. The loans-and-grant policy of our foreign aid program was one of the monumental blunders of economic forecasting in this or any other century.[23] The blunders arose from the fact that the men who made the decisions on the foreign-aid program had really no confidence in their big plans.

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[21] Report at NAC for the period April 1, 1951, to September 30, 1951, pp. 14-15.

[22] Reports of NAC for the period October 1, 1951, to March 31, 1952, p. 13; for the period July 1 to December 31, 1954, p. 24; for the period January 1 to June 30, 1957, p. 30.

[23] If the author, who served at the time as one of the Treasury's lawyers concerned with ERP, be accused of having 20-20 hindsight, his defense is that the Treasury files contain memoranda authored by him specifically advocating local-currency loans (as distinguished from the "counterpart funds" which were usable by the United States only to a very limited extent) rather than grants. If the United States now had drawing rights in French francs, deutschemarks, lire, etc., the Secretary of the Treasury would have to devote less time to worrying about our recurrent balance-of-payments crises.

Perhaps one can understand the generosity in the first years of the Marshall Plan when uncertainty over the future was the order of the day. But can one fathom the blind persistence of this generosity when the evidence began to accrue of the loss of U.S. gold and the surging increases in European gold and dollar reserves? Was not this the time to call a halt for a searching financial examination of U.S. policies?

In the more recent past, especially since 1958, the foreign aid program has been returning to a "loan" basis of a sort, but these loans are largely in terms of repayment in local currencies instead of dollars and lack any maintenance-of-value clauses. Thus, the United States loses to the extent of any devaluation or depreciation of local currencies. For example, the U.S. Treasury has been selling Indonesian rupiahs at an exchange rate of 5,000 to $1 in comparison to U.S. acquisition cost of those currencies under loan agreements at an exchange rate of 45 to $1, a loss on the Indonesian currency loans of more than $.99 on the dollar.

Military "Pay-as-you-go" Abroad Means Huge Cash Transfers to Foreign Countries

U.S. military operations abroad in the past several decades have included large disbursements—aggregating $24 billions for the years 1950-1960.[24] These expenditures were not only for the payment of our troops and their overseas dependents, but also for the payment of foreign troops, various kinds of military assistance, and various supporting operations, such as construction and maintenance of military bases, communications and transportation facilities, use of local real estate for airfields, storage, vast housing developments, and local labor and supplies—even something called "offshore procurement" [25] and "infrastructure." [26] More than half the foreign military expenditures were in Western Europe ($13 billion), with more than half in turn going to France ($3.2 billions) and Germany ($3.5).

[24] Department of Commerce, *Statistical Supplement to Balance of Payments,* Table 41, p. 148.

[25] That is, procurement of equipment and supplies obtained outside the United States (*i.e.,* "offshore") for delivery to our allies. Frequently such "offshore procurement" was made with one NATO member for delivery to another NATO member. The Department of Commerce reported that "offshore procurement" was in excess of $3 billions for the period 1950-1960, *op. cit.,* n. 20, Table 42, p. 148.

[26] That is, headquarters, training, communications, and transportation complex-buildings, pipelines, telecommunications, airfields, etc.

As already stated in the opening of this article, the United States could carry out the far-flung military operations of World War II without then experiencing any balance-of-payments difficulties. The reason was that under lend-lease and reverse lend-lease, there were few if any transfers of credits or cash between the United States and foreign countries.

Under lend-lease the United States furnished its military allies with all the military hardware, guns, airplanes, tanks, ammunition, clothing, food stuffs, and the use of ships. This was done on-the-cuff. In return, the United States received as reverse lend-lease, in the U.K. and later in France and other European countries, use of local real estate for flying fields, barracks, storage depots, maneuvering, local commodities, and services.[27] Thus the Reciprocal Aid Agreement with the United Kingdom, September 3, 1942, para. 2, provided as follows:

> It is the understanding of the Government of the United Kingdom of Great Britain and Northern Ireland that the general principle to be applied, to the point at which the common war effort is most effective, is that as large a portion as possible of the articles and services which each Government may authorize to be provided to the other shall be in the form of reciprocal aid *so that the need for each Government for the currency of the other may be reduced to a minimum* [emphasis added].[28]

[27] The definition of reciprocal aid in para. 3 of the British Reciprocal Aid Agreement of September 3, 1942, reads as follows:

"(a) Military equipment, munitions, and military and naval stores.

"(b) Other supplies, materials, facilities, and services for the United States forces, except for the pay and allowances of such forces, administrative expenses, and such local purchases as its official establishments may make other than through the official establishments of the Government of the United Kingdom as specified in paragraph 4.

"(c) Supplies, materials, and services needed in the construction of military projects, tasks and similar capital works required for the common war effort in the United Kingdom or in the British Colonial Empire, except for the wages and salaries of United States citizens.

"(d) Supplies, materials, and services needed in the construction of such military projects, tasks and capital works in territory other than the United Kingdom or the British Colonial Empire is a more practicable source of supply than the United States or another of the United Nations." E. R. Stettinius, Jr., *Lend Lease* (1944), pp. 382-83.

For a colorful description of the vast variety of reverse lend-lease, also see pp. 183-184, 200-201 (Australia and New Zealand); 216 (India); 308, 310-322, 338 (U.K.).

[28] Stettinius, *op. cit.*, p. 382.

When the war ended, the accounts were struck, and all military items were written off. The United States asked, and received, small payment extending over 30 years only for those items of lend-lease which survived the war and which had a civilian utility. In addition, items still in procurement on "pipeline" were sold at cost plus ocean shipping. The settlements also included the disposal of surplus military equipment and supplies and arrangements for inter-governmental claims.[29]

With the termination of Lend-Lease, U.S. military forces in foreign lands gradually emerged as important dollar earners for the host countries. One would think that the military would have preferred to continue the same methods of operation that had proved so eminently successful in the winning of World War II. However, the Army had powerful incentives for going over to a new basis—called pay-as-you-go. This came about as follows:

As the United States made plans for the liberation of Europe from German control, it was necessary to plan first for the military occupation of the liberated areas. The pervasive operations of economic warfare by Germany, as well as by the United States, required an entirely new currency in the initial phases of the liberation.[30] This military currency retained the same name as the local currency, *i.e.*, the allied military *lira* or the allied military *mark*. The Treasury, which played a predominant role in the financial planning of military liberation and occupation, insisted, during the issuance of military currency by American forces, upon debiting the appropriations of the Army, and to a corresponding extent the Navy, for the dollar equivalents of the amount of military currency distributed. These debits were accumulated in a special suspense account designated as the Allied Military Lira Account and the Allied Military Mark Account.

In the case of Italy, the Allied Military Lira Account was in

[29] For general description of the lend-lease settlements, see the 23rd Report to Congress on Lend-Lease Operations.

[30] After some extended legal surveys of the international authorities, the Treasury had concluded that a military occupant, whether of a liberated area or of an enemy area, had power under international law to issue new military currency and to make the obligation of redeeming such currency an obligation of the occupied area, again whether liberated or enemy. These provisions were, of course, set forth in some detail in the Italian and German armistice agreements. For the Treasury legal opinion, see 80th Cong., 1st Session, Senate Committees on Appropriations, Armed Services, and Banking Hearings on Currency Transactions (1947), pp. 73-94.

a plus condition throughout. However, as Italy's needs for dollars developed, a decision was first made to transfer to Italy for use in civilian relief and reconstruction the dollar equivalent of the allied military lira used to pay the American troops on the ground that Americans were not mercenaries but paid their own troops. As the economic situation in Italy worsened, plans were then made to transfer to Italy the balance of the allied military lira accounts. These plans were dictated by foreign-policy considerations based on the need to rehabilitate Italy, even though the armistice had specifically provided that Italy should redeem the military lira currency. Undoubtedly, these dollars were used to good effect in Italy and were the beginning of aid to that country when it was needed immediately and desperately.

In the case of the Allied Military Mark currency, however, that account was discovered in deficit in late 1945 and early 1946, to the surprise and chagrin of the military planners. The Army had redeemed one billion dollars more of allied military marks than it had issued in the German area under its occupation.[31] This meant that not only was there no dollar equivalent available for the marks that had been issued, but there was now a large deficit in the accounts of the Army. Allied military mark currencies were also issued by other allied forces, such as the United Kingdom, France, and the Soviet Union, and these military currencies were substantially indistinguishable from one another.

When the deficit came up, there were detailed discussions between the Army and the rest of the Executive Branch. The Treasury suggested that the Army should report the deficit and ask for Congressional authorization to write off the deficit. The Army completely opposed this suggestion on the ground that it never had had a deficit of this kind and it did not want to start now. The Army proposed to recoup the dollar loss by selling the excess military marks to the repatriated German prisoners-of-war in the United States who had accumulated dollars for their labor, and also by selling the marks to our soldiers and the military establishment in Germany to be used in paying for various services provided by the German economy, such as hotels, servants, and local supplies, which had previously been furnished free to the United States under the armistice terms. These

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[31] The Army reported to Congress in 1947 that at that time it had excess holdings of $380 million, but unpublished Treasury estimates placed the maximum excess closer to $1 billion.

transactions resulted in the gradual elimination of the dollar deficit in the military mark account over a period of several years. While this solution was first looked upon with some disfavor by the foreign-aid planners, they noted very quickly that, while the Army solution might initially deprive the German economy of dollar earnings, it established the principle that the United States would go over to a pay-as-you-go basis for the local support of our military operation with consequent dollar earnings by Germany, and accordingly they warmly supported the Army's approach. Once the deficit had been worked off, the military establishments found themselves under the precedent of paying everywhere in cash for local facilities and services.

This precedent resulted in very substantial earnings of foreign exchange by such countries as Germany and France in which large United States forces have been maintained for decades. In major part, the tremendous growth in French and German gold holdings in the 1950's can be explained on this basis, as a comparison of Charts I & II dramatically demonstrates. Of course, as those countries assumed military obligations under NATO, they have been sharing some of the burden, particularly in the case of Germany, which in recent years has provided the largest land contingent in the NATO forces. This sharing is not true of France, now only a token participant in NATO, while the NATO infrastructure arrangement became one of the principal dollar earners of the French. At various times there was talk in NATO circles of the "burden sharing exercise," but it remained largely a burden for the United States and an "exercise" for the rest. The aid planners probably enjoyed the cynicism of their humorous choice of words—"exercise"!

Thus were the weeds sown for the coming deficits in the balance of payments of the United States. Like other weeds, they were not deliberately planted, but their spread was preventable, as the record of the United States in World War II so clearly demonstrates. Possibly the weeds grew through over-confidence and inattention.

The first seeding of the weeds of the military deficit was the gradual and rather accidental change in the financial objectives and techniques of the military in maintaining and then expanding forces scattered throughout the world with missions which were not always sufficiently recognized to win local support. Gone were the days of Lend-Lease and reciprocal aid in a struggle for survival when the host countries were equally devoted with the United States to a common cause in which they contributed the local-currency costs of the

common defense. No NATO ally, or any other ally since the ending of World War II, has furnished reciprocal aid to the degree and with the will displayed in the proud performance of the United Kingdom in World War II. Instead the United States embraced and championed "pay as you go" as a first principle, and since the United States did the "going" by maintaining troops and dispatching equipment abroad, it also did the "paying." The presence of U.S. military forces within a host country became an automatic guaranty of financial prosperity for the host, as witness the growth of the hosts' gold (Chart I). But did the embrace of "pay as you go" win for the United States any more devotedly dependable allies than the opposite policy had in World War II?

Gone also were the days of the type of settlement that was contemplated and effected under Lend-Lease: "As for the settlement," said Stettinius in 1944, "that could wait until the danger had passed, and we could take stock of how we and our neighbors stood." [32] No, the settlements were rushed out (in boilerplate style for all the aid recipients) as the aid was gushing out. Those settlements were made at times that stressed the hopelessness of most of the world and consequently were in terms of grants and the shell game whose name was counterpart funds. What if the aid agreements could have kept open the options until the "recovery" phase of the European Recovery Program had become a fact! Or if the United States had taken loan commitments that could have been adjusted downward if the "recovery" were in fact less than called for in the "program"!

Today the United States furnishes the spectacle of pleading with former aid recipients to cooperate with the dollar, while we are peddling war equipment and bonds to host countries to offset the local-currency costs of maintaining U.S. forces for the common defense of host and paying guest. What a contrast to the objectives, techniques, and results of Lend-Lease!

As for the balance of payments of the United States itself, that was largely assumed to be a non-existent problem, as one now peruses the successive semi-annual and annual reports of the NAC for the period from 1947 to 1966. These reports cite the balance of payments as a problem for the United States only twice in those two decades—once in the semi-annual report for the period July to December, 1960, and the other in the following report for the period

[32] Stettinius, *op. cit.*, p. 4.

January to June, 1961. Even then the consideration of the balance-of-payments problem of the United States was confined, so far as the NAC reports reveal, to reprinting in the appendices statements by Presidents Eisenhower and Kennedy. For the rest the NAC reports have been silent on the balance-of-payments problem of the United States.

When the balance-of-payments problem became more pressing for the United States in 1963-1964, the attack was focused on private lending and private investment abroad, rather than on foreign aid and foreign military expenditures and assistance. The private sectors presumably constituted easier targets that were available in ways that did not involve the vested interests and techniques of government. Hence, it was concluded to tax and control private lending and investment rather than to reform foreign aid and the military. Moreover, these taxes and controls fitted in with the need felt for allocation of sacrifice in the current crises.

II. The Interest Equalization Tax

The first measure in defense of the balance of payments of the United States was the Interest Equalization Tax [33] signed into law on September 2, 1964, but made retroactive to July 18, 1963, when it had first been proposed to the Congress by President Kennedy. This legislation is currently scheduled to expire July 31, 1969.

The purpose of the new tax was to reduce the demand on American capital markets from borrowers in industrialized countries by using a graduated excise tax of 15% on the acquisition by persons of stocks of foreign issuers, except in connection with direct investment, and by applying a tax of varying amount on debt obligations, depending upon the length of maturity of the debt. This tax ranges from 2¾ % to 15% if the securities are held for more than x number of years.

The tax was originally described as a temporary tax to expire at the end of two years. Thus, it was originally limited to the period ending on December 31, 1965. It has been twice extended by Congress, first to end on July 31, 1967, (Public Law 89-243, § 2) and later to end on July 31, 1969 (Public Law 90-59, § 2). The reasons for its temporary nature and the successive renewals were errors in judgment as to the time required to protect the balance-of-payments

[33] 26 U.S.C. 4911, *et seq.*

position of the United States. It was constantly hoped that this position would improve rather than deteriorate. Since, however, the balance-of-payments position of the United States may not improve significantly by the termination date of July 31, 1969, there is every expectation there will be a further extension of the Act. However, the investing community has now become sufficiently accustomed to the tax that it is unlikely that further renewal would present any serious congressional problems. The legislation did not initially apply to transactions in advanced stages of negotiation at the time of the announcement of the proposed tax by the President on July 18, 1963.

> According to the Treasury's recent study (1968) the major motivation for the increased borrowing by other industrialized countries in the U.S. capital market was the higher level of interest rates prevailing in these countries rather than a need on the part of the foreign borrowers for foreign exchange. The purpose of the IET was to compensate for this interest rate differential by increasing by the equivalent of 1% per year the cost to borrowers from other industrialized countries of raising long-term capital in the U.S. market. * * *
>
> The IET was not designed to halt completely the outflow of private portfolio capital from the U.S. to the countries concerned, but rather to restrain the rate of outflow to a more normal level and thus relieve the pressure on the U.S. balance-of-payments position.[34]

The tax legislation employs language which is exceedingly complicated and highly technical. If ever any proof were necessary for the detailed controls that are evolving out of the balance-of-payments controls, the interest equalization tax is a foreboding example. The exemptions contained in it are exceptionally numerous and reflect the responses of Congress to a great variety of pressures brought on behalf of specific persons or groups that believed they would be adversely affected by the tax. The general justification for these exemptions is that the tax was not intended to apply to transactions that are necessary for the normal conduct of international business, provided that they do not have significantly adverse effects upon the balance of payments of the United States. However, with the vast growth of international transactions in the post-war period the concept of "normal" has obviously been growing in all directions.

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[34] Treasury, *op. cit.*, n. 7, Tab. D, p. 1.

The major exemptions of the interest equalization tax are as follows:

(1) Prior American ownership. The interest equalization tax does not apply to foreign securities purchased from an owner who is a United States person.[35] A signed certificate of prior American ownership in connection with the acquisition of foreign security is considered adequate proof of prior American ownership unless the person receiving the certificate has actual knowledge that the certificate is false. There have already been prosecutions instituted for false certificates. In the case of securities purchased on most registered national securities exchanges, or from a member of a national securities association registered with the Securities and Exchange Commission, the purchaser may normally rely upon a written confirmation of the transaction and need not obtain a certificate of American ownership.

(2) Direct investments. The interest equalization tax does not apply to direct, as distinguished from portfolio investment.[36] Direct investment is defined as acquisitions by U.S. persons of stock or debt obligations where immediately after the acquisition the U.S. person owns, directly or indirectly, 10% or more of the combined voting power of all classes of stock of the foreign corporation.[37] The same exemption is also available to the acquisition of an interest in a partnership.

(3) Less-developed countries. The interest equalization tax does not apply to acquisitions of debt obligations issued or guaranteed by a national or local government of a less-developed country, stock or debt obligations of a less-developed country corporation, debt obligations issued by individuals or partnerships resident in less-developed countries, and certain reinvestments required by the laws of the less-developed countries.[38] The designation of less-developed countries is set forth in E.O. 11285. No country within the Sino-Soviet bloc may be designated as a less-developed country for purposes of the tax.[39] The Treasury has established procedures for determining when a corporation can qualify as a less-developed-country corporation, in general under the 80% rule.

[35] 26 U.S.C. 4918.
[36] 26 U.S.C. 4915.
[37] 26 U.S.C. 4916 (a)(1).
[38] 26 U.S.C. 4916.
[39] 26 U.S.C. 4916 (b) and § 2 of E.O. 11285.

(4) Commercial bank loans. The interest equalization tax originally exempted debt obligations acquired by commercial banks in making loans in the ordinary course of commercial banking business.[40] This was done on the assumption that most commercial bank loans would fall within the maturity range of less than three years and therefore would not in any event be subject to the tax originally imposed. The exemption was also based on the assumption that most foreign loans by banks are related to U.S. exports. The legislation, however, authorized the President to bring commercial bank loans with maturities of three years or more under the tax if he determined that such loans were impairing the effectiveness of the tax, and the President was also empowered to impose a tax on debt obligations with a maturity of one to three years acquired by commercial banks.[41] These steps were taken under Executive Order 11198 whereby, acting under the authority of § 4931 of the Internal Revenue Code, as amended, the President invoked the Gore Amendment and imposed the tax on commercial bank loans having a maturity of one year or more.[42] This was done at the same time that a comprehensive, voluntary balance-of-payments program for banks and other businesses investing abroad was announced, *infra,* pp. 423-429. However, the Gore Amendment contained express exclusion in § 4931(d)(1) for acquisitions by commercial banks of debt obligations, regardless of their duration, arising from export transactions. This exclusion was further incorporated in the Executive Order and the Treasury regulations. The Executive Order also continued the exemption for investments in and loans to foreign subsidiaries of U.S. banks and for loans by foreign branches of U.S. banks.

(5) Export financing. There are a series of detailed exemptions for foreign stock and debt obligations acquired as a result of U.S. export transactions; guaranties by U.S. Government agencies, such as the Export-Import Bank; exemption for goods produced in the United States if 85% or more of the purchase price is attributable to the sale of such property or to the performance of services by U.S. persons or both; the exemption for U.S.-producing exporters in exchange for foreign stock or debt obligations; the export of intangible property rights, such as the sale or licensing of patents, inventions, copyrights, secret processes, trademarks, goodwill, etc. There are

[40] 26 U.S.C. 491 (b)(2).
[41] 26 U.S.C. 4931.
[42] At 26 U.S.C.A., pp. 456-57.

also exemptions for export-related loans.[43] Thus acquisition of a debt obligation is exempt from the tax if the U.S. person making the loan and receiving the debt obligation shows that the proceeds of the loan will be used for storage, handling, transportation, processing, packaging, or servicing outside the United States of property substantially produced, grown, or extracted by the lender in the United States.

(6) International monetary stability. In view of the near panic condition that immediately developed in Canada upon the President's announcement of the new tax, the statute authorized the President to exempt from the interest equalization tax new security issues of a foreign country where he determined that the application of the tax would imperil or threaten to imperil the stability of the international monetary system.[44] It was understood that this exemption at the time applied only to Canada.[45] Later, the exemption was extended by Executive Order to cover Japan up to an aggregate annual amount of $100 million of new debt obligations issued or guaranteed by the Japanese government.[46]

(7) U.S. underwriters and security dealers. U.S. underwriters and dealers in foreign securities are subject to the interest equalization tax when they buy a foreign security for a U.S. person.[47] However, if a sale is subsequently made to a foreign person, the underwriter or dealer may claim a credit or refund of the tax.

(8) Stock of foreign corporations controlled and traded in the U.S. Certain foreign corporations are treated as domestic corporations with respect to certain classes of their stock for purposes of the interest equalization tax, thus exempting the purchases of such classes of stock from the tax.[48] Any class of stock in a foreign corporation traded on the U.S. securities exchange qualifies for this treatment if the trading on such exchanges represented the principal market for such class of stock during 1962 and if more than 60% of such class of stock was held by U.S. persons on the latest record date before July 19, 1963. Lists of securities qualifying under this exemption have been made available by the principal U.S. stock exchanges. Any class of stock of a foreign corporation also qualifies for exemption

[43] 26 U.S.C. 4914 (c).
[44] 26 U.S.C. 4917.
[45] E.O. 11175, at 26 U.S.C.A., p. 425.
[46] E.O. 11211, at 26 U.S.C.A., pp. 425-26.
[47] 26 U.S.C. 4919.
[48] 26 U.S.C. 4914 (i).

if 65% of such class of stock was owned by U.S. persons on the latest record date before July 19, 1963.

The Treasury has appraised the effect of the interest equalization tax as follows:

> After the adoption of the IET new foreign security issues subject to the tax have virtually ceased. U.S. transactions with foreigners in outstanding foreign stocks and bonds, which had regularly resulted in substantial net U.S. purchases for years prior to the IET, shifted to net sales from the middle of 1963 through 1966. For the first three quarters of 1967, there was a resumption of net purchases but on a very limited scale. Long-term commercial bank loan commitments to foreigners in countries subject to the IET have fallen to a small fraction of the pre-tax level, as compared with only a moderate reduction in commitments to countries not covered by the tax.[49]

Table II shows the statistical effect of the tax on the market in foreign-issued securities.

III. Voluntary Controls over Foreign Lending and Investment

The legislative process of enacting the interest equalization tax into law took far longer than the Executive had anticipated. During this period, however, it had been repeatedly stated that the tax would be retroactive to the date of the President's proposal. This warning and attendant uncertainty as to the effective date and scope of the statute-to-be were successful in reducing the acquisition of foreign securities by U.S. citizens and corporations to an extraordinary degree (see Table II). However, during this waiting time there was substantial increase in the outflow of capital abroad in the form of bank and other credits which were expressly excluded from the initial form of the interest equalization tax. Accordingly, when President Johnson announced on February 10, 1965, that he was invoking the Gore Amendment to extend the interest equalization tax to commercial bank loans having a maturity of one year or more, *supra,* he also announced that there would be instituted a program for a voluntary effort by U.S. banks and other business to reduce foreign transactions.[50]

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[49] Treasury, *op. cit.,* n. 7, Tab. D, p. 2.
[50] E.O. 11198.

TABLE II

New Issues of Foreign Securities Purchased by U.S. Residents, by Area, 1962-1966

($ millions)

	1962	1963 First Half	1963 Second Half	1964	1965	1966	1967 First Half *
TOTAL NEW ISSUES	1,076	999	251	1,063	1,206	1,210	758
IET Countries:							
West Europe	195	219	53	20	80	15	—
Japan	101	107	57	—	52	4	—
Other [1]	60	17	—	—	—	—	—
Subtotal	*356*	*343*	*110*	*20*	*132*	*19*	—
Of which:							
(i) Subject to IET			—	—	80	9	—
(ii) Exempt from IET:			110	20	52	10	—
Reason:							
a) Commitments made prior to 7-18-63			(110)	(—)	(—)	(—)	(—)
b) U.S. export-related			(—)	(9)	(—)	(—)	(—)
c) Japanese exemption			(—)	(—)	(52)	(—)	(—)
d) Other			(—)	(11) [3]	(—)	(10) [4]	(—)
Other Countries:							
Canada	457	608	85	700	709	922 [5]	497
Latin America [2]	102	13	23	208	37	69	58
Other countries	77	35	33	131	149	120	98
International institutions	84	—	—	4	179	80	104
Subtotal	*720*	*656*	*141*	*1,043*	*1,074*	*1,191*	*757*

1 Australia, New Zealand, South Africa.
2 Includes Latin American Development Bank issue of $145 million in 1964.
3 Issue had maturity less than three years, which was lowest maturity to which tax had applied prior to February 11, 1965.
4 Issue by United Kingdom subsidiary of Canadian firm.
5 Before deducting $162 million of Canadian Government purchases from U.S. residents of outstanding Canadian and other foreign securities in accordance with Canada's agreement not to let its foreign exchange reserves rise as a result of borrowing in the U.S.

Source: U.S. Treasury Department, *Maintaining the Strength of the United States Dollar in a Strong Free World Economy* (1968), Table 15 (p. 120), Tab B, Table 1.

A. *Business Investment*

On February 18, 1965, the U.S. Department of Commerce issued a statement of general policy requesting voluntary cooperation from the business community in effecting investments abroad.[51] During the week of March 14, 1965, a form letter sent by the Secretary of Commerce to some 600 U.S. corporations having substantial foreign business operations contained an appeal for the support of the program and requested the furnishing of certain financial information to the Department of Commerce and a quarterly reprinting program containing data on past transactions (including 1964 as a whole) and quarterly projections for the following year.[52] This letter placed more emphasis upon a flexible voluntary program of improve-

51 Department of Commerce Press Release, dated February 18, 1965.
52 *Ibid.*, dated February 24, 1965.

ments for each company. Among the principal points made were the following:

1. United States firms with foreign investments of $10 million or more at the end of 1964 or exports of $10 million or more were asked individually to participate in the program to achieve an average improvement of 15% to 20% in 1965 in the overall performance in the balance of payments by United States corporations, as compared with 1964.

2. Wherever possible short-term assets (mainly interest-bearing bank deposits and short-term commercial and government obligations) should not be increased above the volume outstanding on December 31, 1964, and should, wherever possible, be reduced to the level outstanding at the end of 1963.

3. The chief executive of each firm was asked to return with each questionnaire a commentary describing the steps they had taken to achieve the improvement indicated and the reasons for shortfalls, if any.

4. Each participating firm was requested to notify the Secretary of Commerce of new investment projects of $10 million or more to be undertaken in developed foreign countries. The notification included a general outline of the proposed financing.

5. Business firms were encouraged to pursue a number of policies to improve the balance in 1965 by alternative means:

a. Expansion of exports through independent channels and to or through foreign affiliates.

b. Development of new export markets in countries in which they are not active.

c. Acceleration in the repatriation of income earned in developed countries.

d. Avoidance or postponement of direct investment in marginal projects and in projects which do not quickly result in higher exports or investment incomes in developed countries with funds raised in the United States or earned abroad and which would ordinarily be repatriated.

e. Greater use of funds raised in developed countries to finance direct investments in those countries, although the financing charges are higher than in the United States.

f. Sale of equities in foreign subsidiaries to residents of the host countries.

g. Increased use of American flag vessels and airlines.

h. Minimization of the outflow of short-term financial funds and orderly repatriation of such funds previously invested abroad.

In 1965, direct investment by a particular company was not subjected to special analysis apart from its inclusion as one factor entering into the overall balance-of-payments performance. However, in 1966, specific company guidelines for direct investment were imposed.[53] These guidelines limited each corporation's direct investment for the two-year period 1965-1966, to 90% of that corporation's direct foreign investment during a base period of 1962-1964. Insofar as corporations had made sizable foreign investments in 1965, they were severely restricted in 1966, while those with modest direct investments direct and outflows in 1965 could well have quite a lot of room in which to maneuver in 1966.

The Commerce Department required that the participating companies file detailed forms showing the amounts available for foreign investment in 1966. Worksheet 1 was required of each company in which it made a forecast of its 1966 transactions which would have significant effects upon the balance of payments. Worksheet 2 was required of each company to compute its direct investment target. In addition, the companies filed quarterly worksheets reporting the actual transactions upon which the estimates of Worksheet 1 were made. The number of companies requested by the Department of Commerce to participate in voluntary programs rose from 500 in 1965 to approximately 900 in 1966. It is estimated that the 900 companies account for the great majority of total foreign investment by U.S. companies. It is understood, however, that reports had not been received from many companies and that the response from some of the smaller companies included in the request was regarded as disappointing.

The voluntary restraints applied only to selected transactions. Thus all imports and all transactions with less-developed countries have been outside the scope of the voluntary program and were not restrained in any way. Canada has been largely exempt from the program upon a kind of gentlemen's agreement that it would not run

[53] 5 *Int. Leg. Materials*, 30, *et seq.*, (Jan., 1966).

up its gold stock at the expense of the United States. Other significant balance-of-payments items, such as royalties, fees, service charges, and like transactions with unaffiliated foreign interests, so far have received relatively little attention, although they usually represent a substantial net benefit to the U.S. balance-of-payments position. The Department of Commerce has usually been praising the effectiveness of the program, whereas there has been considerable outside opinion that it has not been effective to the degree claimed by the Department of Commerce. One significant and novel development has been the stimulation of European bond and debenture issues by specially organized financing subsidiaries of U.S. companies and the consequent expansion of the European capital market. Undoubtedly, in many instances, the voluntary controls cost the postponement and rescheduling of a certain amount of investment in developed countries, but this had the concomitant effect of building up a backlog of deferred investments with relatively high foreign exchange requirements. There has also been a rapid and ingenious construction of financial syndicates for raising long-term capital in Europe to be used in the foreign operations of American companies in the place of U.S. funds to which they have had access in the past. Of course, this has considerably raised the cost of such funds to the American investor.

B. *Loans by Commercial Banks*

Detailed guidelines for commercial banks were issued by the Federal Reserve Board on March 5, 1965,[54] outlining the following points:

1. All commercial banks should restrict credits to foreigners, including loans and investments, acceptances and deposits, and particularly those which are not clearly and directly for the purpose of financing exports of the United States goods and services. The desired goal is to hold outstanding credits other than export credits during 1965 to a level not over 5% above the amount outstanding on December 31, 1964, (which for all commercial banks was $10 billion). Banks exceeding their 5% target should act to reduce their claims to 105% of the base as quickly as possible.

2. The restraint is not applicable to export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees

[54] Federal Reserve Board, Circular No. 5628.

or insurance, and holdings of "Export-Import portfolio fund" participations.

3. The 5% goal applies whether the loans and other credits are subject to the interest equalization tax or not.

4. Within the 5% guideline, absolute priorities should be considered for export credits and, in the case of no export credits, loans to less developed countries, Canada, Japan, and the United Kingdom.

5. Banks were directed not to sell existing claims on foreigners to United States residents and replace such assets with other loans to foreigners. Banks with no previous foreign lending experience were expected not to make foreign loans during 1965, other than in the case of export financing in reasonable amounts, provided such financing does not represent a shift from previous United States or foreign sources of financing.

6. Foreign branches of United States banks were not to be hampered in lending activities involving funds, including Euro-dollar deposits, derived from foreign sources and not adding to the dollar outflow.

7. Loans by a foreign Edge Act subsidiary of a United States bank could be combined with the parent bank for purposes of the program, or separate targets could be set for the parent bank and the subsidiary.

8. The program was voluntary but involved reporting requirements and close consultation with the Federal Reserve Board.

C. *Loans by Nonbank Financial Institutions*

The Federal Reserve Board issued guidelines for foreign lending activities of nonbank financial institutions on March 4, 1965.[55] The nonbank financial institutions include insurance companies, savings banks, investment companies, mutual funds, finance companies, pension funds, charitable trusts and foundations, and trust departments of commercial banks. The program called for the following steps:

1. Liquid funds held abroad should be limited to the December 31, 1964, year-end total, and the longer term objective was to reduce such investments to the December 31, 1963, level. Liquid investments are defined as dollar-denominated deposits in foreign banks and foreign branches of United States banks, short-term securities of foreign governments and their foreign instrumentalities, foreign com-

[55] *Ibid.*, Circular No. 5627.

mercial paper, finance company credits and bankers acceptances, and all other negotiable instruments maturing in one year or less. Foreign bank deposits in foreign currencies may be maintained to support ordinary foreign business operations.

2. Investments other than liquid funds, with maturities of five years or less, should not be increased by more than 5% during 1965 over the amount held at the end of 1964, without regard to the type of instrument or the country of origin. Priorities should be given to credits that directly finance United States exports.

3. Investments in foreign offices, branches, and subsidiaries were limited to the fullest extent practicable during 1965. Ordinarily expansion of credit to such foreign branches and subsidiaries should be held within 5%.

In marked contrast to the voluntary controls for business were the controls over banks and other financial institutions. The banking controls are quite simple in that they consist of nothing more than a series of restraints on the growth of foreign lending operations of U.S. financial institutions. This contrasted with the voluntary Commerce Department program, which must deal with different types of capital flows and with the enormous variety of non-financial industries.

To a certain extent it was unrealistic to refer to the Federal Reserve controls as voluntary, as E.O. 11387 (para. 2) clearly recognizes. There seems to have been no question on the part of either the Federal Reserve or the banks subject to its regulation that the program would be promptly complied with in both letter and spirit. Moreover, it should be noted that a few large banks and financial institutions are responsible for the bulk of foreign lending.

IV. Mandatory Controls over Foreign Investment

The voluntary controls over business investment came to an abrupt end with the issuance of E.O. 11387 on January 1, 1968,[56] under 5(b) of the Trading-With-the-Enemy Act, as amended.[57] The ostensible occasion for the mandatory controls was "the importance of strengthening the balance-of-payments position of the United States," according to the Executive Order. The new controls [58] speak

[56] Corrected reissue of Federal Register, Vol. 33, No. 1 (Jan. 3, 1968).
[57] 12 U.S.C. 95 (a) or 50 War App. 5.
[58] FDIR, n. 2 *supra*.

in the language of prohibitions, requirements, and reports, with enumerated criminal sanctions. The "voluntary" controls of the Federal Reserve Board, *supra,* also could become mandatory, at the option of the "Fed" under § 2 of the Executive Order.

The mandatory controls are two-pronged—(1) they prohibit the transfer, whatever the form, of capital abroad unless licensed by the Secretary of Commerce,[59] and (2) they require the repatriation of earnings from abroad and the reduction of bank deposits and other short-term financial assets abroad.[60] True, the scope of the controls was still limited to "big" investors, involving transactions of a minimum of $100,000 per year.[61] Nor does an investor fall within the scope of the mandatory controls unless he is a "direct" investor in the sense, as originally defined under the interest equalization tax, *supra,* namely, a person who directly or indirectly owns or acquires 10% or more of the total combined voting power of any foreign national, or has the right or power to receive, control, or otherwise enjoy 10% or more of the earnings, receipts, income, or profits of any foreign national; or has the right or power to receive, control, or otherwise direct the disposition of 10% or more of the assets of any foreign national.[62]

By first prohibiting or requiring almost anything, and then licensing out various transactions, the new mandatory controls were patterned upon the old Foreign Funds Control or Foreign Assets Control of the Treasury, which have enjoyed such effective immunity from judicial review.[63] That form of control has also led to a remarkable silence on the part of the business critics, who may still hope for licenses or authorizations and hence do not speak up.[64] To a lawyer

[59] Subpart B, § 1000.201.

[60] FDIR, Subpart B, § 1000.202 and 1000.203.

[61] FDIR, Subpart E, § 1000.503.

[62] FDIR, Subpart C, § 1000.304.

[63] See Silesian American Corporation v. Clark, 332 U.S., 469, 92 *L.Ed.* 81 (1947); Propper v. Clark, 337 U.S. 472, 93 *L. Ed.* 1480 (1949); and Cikes Service Co. v. McGrath, 342 U.S. 330, 96 *L.Ed.* 359 (1952).

[64] In a column in the *Wall Street Journal* for Feb. 23, 1968, entitled "Money Controls Kindle Academic Ire," Richard F. Janssen notes:

"Yet, in public at least the only walls reverberating with any angry attack are the ivied battlements of academe, where scholars of international finance and Constitutional law reside; the business community's reaction has been remarkably restrained.

"True, the relative anonymity of trade groups like the U.S. Chamber of Commerce may eventually make them a collective outlet for corporate dissent.

not initiated in the esoteric draftsmanship of the Trading-With-the-Enemy regulations, the new mandatory controls and their bewildering terminology may usher in an entirely new world, largely uncharted and with uncertain shoals and reefs, while stormy weather lurks no one knows quite where. The lawyer's best hope in advising a client is, so far, to obtain some kind of authorization or license, which tends, in many cases, to be oral. The confusion was initially compounded by inadvertent typographical errors which have now been corrected.

The prohibitions on capital transfers apply to the transfer of credits, payments between, by, through, or to any banking institution —and almost anybody is a "banking institution" under the definitions —transactions in foreign exchange or relating to any property located in a foreign country.[65] The mandatory controls define "banking institution," as did the Treasury regulations of World War II, as "any person holding credits for others." [66] Except for the aggregate dollar limitation of $100,000, anybody can qualify as a "banking institution," since he at some time or other owes money to someone else, however short the period. If this definition is not broad enough, the new controllers are authorized to write their own definitions.[67] This is innovative even under the Trading-With-the-Enemy Act and its sweeping regulations.

The mandatory controls classify the world (except for Canada, which was specially exempted)[68] into three main categories: (1) The "A" countries of the less-developed countries,[69] as listed in § 4916 of the Internal Revenue Code, (2) the "B" countries [70] which include

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But so far, individual businesses are mostly limiting themselves to polite petitions for clarification or for an occasional exemption.

"Reasons for Reticence

There's an unpleasant reason for this reticence, charges Prof. Robert A. Mundell, a University of Chicago economist: 'Any acquiescence to the controls is based on the special interests of the lobbies hoping for special exemptions and fearful of reprisals if they do react publicly against the Government's policy.' "

[65] FDIR, Subpart B, § 1000.201(a).

[66] FDIR, Subpart C, § 1000.311. The sweeping definition of "an institution" in the Treasury wartime freezing controls was specifically upheld by the Supreme Court in Propper v. Clark, 337 U.S. 472, at p. 479, 93 *L.Ed.* 1480 (1949).

[67] § 3 of E.O. 11387.

[68] Fed. Register, March 12, 1968, p. —.

[69] FDIR, Subpart C, § 1000.319(a).

[70] *Ibid.*, 1000.319(b).

many developed countries, such as the United Kingdom, Canada, Japan, and Australia, and also some less-developed countries that are very important to U.S. industry, such as the oil areas, and (3) the "C" countries or the rest of the world.[71] The "B" countries are characterized by the fact that they are actively cooperating with the United States in the defense of the dollar against attack by gold hoarders.

This country classification is to a certain extent a lazy classification in that it builds upon distinctions already drawn in the tax laws for entirely different purposes and different times. The system fails to recognize that there are many less-developed countries which have intimate financial relationships with highly developed countries, such as France, which are embarked upon a major onslaught on the dollar. The result of that relationship is that the exemption of countries as less-developed provides a major source of seepage of U.S. funds into France. It would make far more sense to classify the countries into two categories, namely, (A) the countries which enter into satisfactory financial arrangements with the Secretary of the Treasury of the United States for the cooperative defense of the dollar, and (B) countries which do not. If it were politically necessary to make some special treatment of the western hemisphere, then there should be exclusion of those areas, such as Caribbean islands, which do not cooperate with the defense of the dollar. As time passes this classification of countries will come under more critical scrutiny.

The controls permit transfer of capital [72] to schedule "A" countries up to 110% of the average of direct investment by the direct investor in all Schedule "A" countries during the base years 1965 and 1966. Transfers to a Schedule "B" country are limited to 65% of the base period, while a complete "moratorium" is placed on transfers to any Schedule "C" country.

A somewhat different and more complex regime applies to the direction to investors for the repatriation of earnings.[73] A direct investor is required to repatriate from Schedule "A" countries either the excess of earnings over the percentages repatriated during an averaged base-period (1964-1966) or the amount of the excess of earnings over the amount that may be reinvested as part of the 110% capital transfer, whichever is greater; from Schedule "B" countries,

[71] *Ibid.*, 1000.319(c).
[72] FDIR, Subpart E, § 1000.504.
[73] FDIR, Subpart B, § 1000.202.

either the base-period standard (1964-1966) or the excess over the 65% permissible capital transfer whichever is greater; and from Schedule "C" countries, either the base-period standard or the excess over 35% of the investment in the "C" countries during the average of 1965-1966, whichever is greater.

The repatriation requirement is an innovation that is likely to prove rather troublesome in operation. Unless the direct investor has voting control of the foreign project, the amount of repatriation of earnings necessarily depends upon the corporate decision of the project directors, and is moreover subject to the foreign exchange laws and regulations of the country concerned. There are thus two decisions—one private and the other governmental—that may be beyond the control of the direct investor, and hence the reach of the U.S. controls.

Unlike the interest equalization tax, which exempted from its provisions most pending transactions, the new mandatory controls in form apply to all transactions, regardless of their stage of performance. The result was predictably a wave of thousands of requests for special licenses and authorizations. Part of the administrative pressure was reduced by the issuance of General Authorization No. 1 on January 22, 1968, relating to guaranties and payments of indebtedness under pre-existing loan commitments or lines of credit, delivery of securities, etc., where transfers were authorized.[74]

But this is just the beginning of the mandatory controls. The Secretary of Commerce has issued the form of reports required under the regulations. The basic form, "Base Period Report," *supra*, p. 434, is a rather formidable form and is supplemented by additional forms directed at the following:

Supplement 1	Identification of Direct Investor
Supplement 2	Identification of Affiliated Foreign Nationals
Supplement 3	Foreign Borrowing by the Direct Investor and Foreign-Incorporated Finance Subsidiaries (Parts A and B)
Supplement 4	Borrowings by Affiliated Nationals From Non-Affiliated Persons Within the United States
Supplement 5	Exploration for, and Development of, Foreign Gas, Oil and Other Mineral Resources
Supplement 6	Transactions with Affiliated Foreign Nationals Engaged in Shipping

[74] 7 *Int. Leg. Materials*, 62-63 (January, 1968).

Form Approved; Budget Bureau No. 41-R2440

FORM FDI-101
(2-68)

U.S. DEPARTMENT OF COMMERCE
OFFICE OF FOREIGN DIRECT INVESTMENTS

BASE PERIOD REPORT

Show amounts in thousands of U.S. dollars - show reverse flows or opposite entries in parentheses ( )

NOTE: *This report must be completed in accordance with the Foreign Direct Investment Regulations and the Instructions to this form.*

This report, including supplements, is required under Executive Order 11387, January 1, 1968 and the implementing Foreign Direct Investment Regulations of the U.S. Department of Commerce.

Return one copy of this form and supplements to:

Program Reports Division
Office of Foreign Direct Investments
U.S. Department of Commerce
Washington, D.C. 20230

Name and address of reporter *(Street, City, State, Zip code)*

State principal type of business in which reporter is engaged *(Also give Standard Industrial Classification Code, if known)*

CATEGORY OF TRANSACTIONS		Schedule A countries			Schedule B countries			Schedule C countries			DATA FOR 1967		
Reporting period: ☐ Calendar year; ☐ Fiscal year; ☐ From ________ to ________		1964	1965	1966	1964	1965	1966	1964	1965	1966	Schedule A countries	Schedule B countries	Schedule C countries
CALCULATION OF REPATRIATION RATIOS OF DIRECT INVESTOR RESPECTING EARNINGS OF AFFILIATED FOREIGN NATIONALS INCORPORATED IN FOREIGN COUNTRIES													
Earnings:													
1. Share in earnings, excluding losses	01												
2. Share in losses (debits) for each period	02												
3. Share in net earnings (or net losses), line 1 plus line 2	03												
Dividends:													
4. Dividends received by the direct investor before deducting foreign withholding taxes *Do you elect to treat dividends received in the first 60 days of the year as received in the previous year?* ☐ Yes ☐ No	04												
5. Foreign withholding taxes	05												
6. Dividends received, net of foreign withholding taxes, line 4 less line 5	06												
Reinvested Earnings:													
7. Direct investor's share in reinvested earnings, line 3 less line 4	07												
Repatriation Ratios:			Total Amounts 1964 - 66	Repatriation Ratio line 8/line 9		Total Amounts 1964 - 66	Repatriation Ratio line 8/line 9		Total Amounts 1964 - 66	Repatriation Ratio line 8/line 9			
8. Dividends, before deducting foreign withholding taxes, for 1964, 1965, and 1966, from line 4	08		——— =	%		——— =	%		——— =	%			
9. Share in net earnings for 1964, 1965, and 1966 from line 3	09												
DIRECT INVESTMENT TRANSACTIONS WITH AFFILIATED FOREIGN NATIONALS:			1965	1966		1965	1966		1965	1966			
10. Net transfers of capital to (or from) affiliated foreign nationals (sum of lines 10a and 10b)	10												
a. Affiliated foreign nationals incorporated in foreign countries	11												

b. Affiliated foreign nationals not incorporated in foreign countries	12												
11. Specified transfers of capital between affiliated foreign nationals in different Scheduled Areas	13												
12. Less: Net foreign-borrowed funds expended for direct investment, from line 11, Form FDI-101, Supplement 3 Part (B)	14												
13. Sum of transfers shown in lines 10 and 11 less amounts shown in line 12	15												
14. Direct investor's share in reinvested earnings, from line 7	16												
15. Direct investment transactions, sum of lines 13 and 14	17												
								Alternate calculations of reinvested earnings Schedule C countries					
CALCULATION OF DIRECT INVESTMENT LIMITS:		Annual Average 1965 - 66 from line 15	Times % Authorized	Calculated Direct Investment	Annual Average 1965 - 66 from line 15	Times % Authorized	Calculated Direct Investment	Annual Average 1965 - 66 from line 15	Times % Authorized	Calculated Reinvested Earnings (Section 1000.504)	Projected 1968 Earnings	Times % Reinvested 1964 - 66 (100% less % from lines 8 & 9)	Calculated Reinvested Earnings (Section 1000.202)
16. Application of direct investment formulas	18		110%			65%			35%			%	
LIQUID FOREIGN BALANCES OF DIRECT INVESTORS:			24 months 1965 - 66			24 months 1965 - 66			24 months 1965 - 66		12 months 1967	12 months 1967	12 months 1967
17. Average of end-of-month balances in specified periods, excluding proceeds of certain foreign borrowings	19												
OTHER TRANSACTIONS WITH AFFILIATED FOREIGN NATIONALS:		1964	1965	1966	1964	1965	1966	1964	1965	1966	DATA FOR 1967		
18. Earnings of affiliated foreign nationals not incorporated in foreign countries	20												
19. Interest receipts from affiliated foreign nationals	21												
20. Royalties, fees, rentals, and the like received from affiliated foreign nationals	22												
21. Specified net transfers of capital between affiliated foreign nationals in different Scheduled Areas	23												

Corporate Seal *(If reporter is corporation)*

CERTIFICATION - The undersigned certifies that the above statements, including those in the accompanying supplements, are true, correct, and complete to the best of his knowledge and belief. (Certification by independent public accountants is not required.)

Date	Signature *(Of duly authorized officer if reporter is corporation)*	Title of officer *(If reporter is corporation)*

PREPARER OF FORM *(Individual or firm)*

Name of preparer	Address *(Street, City, State, Zip code)*	Telephone No. and Area code

The information submitted in answer to the questions contained in this form will be used solely for official purposes as authorized by the Secretary of Commerce or his delegates. The unauthorized publication or disclosure of individual company information by Government personnel is prohibited by law, and such personnel having access thereto are subject to fine and imprisonment for unauthorized disclosure.

Comments and notes may be appended to this form where the reporter so desires.
With respect to this form and the supplements thereto, if additional space is required in any instance, continue reporting on appended sheets.

The preparation of these forms will require unimaginable hours of effort on the part of accountants, economists, treasurers, lawyers. The results will be photocopied or printed into bulging folders and reports at staggering costs, financial and psychological. And what will the staffs of the Secretary of Commerce do with the resulting avalanche of papers?

All of this has been ordered by the government in defense of the balance of payments of the United States. The causes of the deficits in that balance demonstrably lie elsewhere than in business investment or banking or other financial operations abroad. *Per contra,* business investment, banking, and other financial operations have invariably reduced our deficits, as Chart II proves. The causes of the deficit are writ in recent history. The attack on the deficit must needs come there: the financial operations of our own government abroad. That remedy has not yet been fully recognized by our government. And so long as the obvious remedy eludes us, we will continue to be plagued with deficits in our balances of payments. And if we continue down the present road of mandatory controls over business investment, the deficit will only continue to grow, for these controls reduce future capital inflow [75] as returns on the controlled capital outflow necessarily decline. But, then, is not that the historical way with massive controls over the economy?

[75] Assuming no major change in the quality and purposes of new investment abroad.