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THE MULTINATIONAL CORPORATION AND THE WORLD ECONOMY

COMMITTEE ON FINANCE
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RUSSELL B. LONG, *Chairman*

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Subcommittee on International Trade

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THE MULTINATIONAL CORPORATION AND THE WORLD ECONOMY

Introduction

Friction between the multinational corporation, with its supranational point of view, and the nation-state with its national economic concerns, has given rise to a host of economic and political problems.

What is at issue today is the degree of freedom that multinationals should have or the extent of regulation that should be imposed on their present operations and future growth. Two developments in the past fifteen years have focused public attention on multinational corporations: first, the massive influx of U.S. capital into Europe; and second, the continuing deficit in the U.S. balance of payments.

The Labor Charge

In the United States, organized labor has charged that multinational corporations export American jobs through the transfer of precious technology and productive facilities to foreign nations; erode our tax base and exacerbate our balance of payments problems.

In testimony before the Subcommittee on International Trade of the Senate Finance Committee in May, 1971, AFL-CIO President George Meany stated:

"Operations by American companies obviously displace United States produced goods in both American markets and world markets. These companies export American technology—some of it developed through the expenditure of Government funds paid by American taxpayers. Their biggest export, of course, is United States jobs.

"These multinational firms can juggle the production of parts and finished products from one subsidiary in one country to another. A multinational corporation can produce components in widely separated plants in Korea, Taiwan, and the United States, assemble the product in Mexico and sell the product in the United States at a U.S. price tag and frequently with a U.S. brand name. Or the goods produced in the multinational plants in a foreign country are sold in foreign markets, thus taking away the markets of U.S.-made goods.

"The multinational firms can juggle their bookkeeping and their prices and their taxes. Their export and import transactions are within the corporation, determined by the executives of the corporation—all for the benefit and profit of the corporation. This is not foreign trade. Surely it is not foreign competition.

"The complex operations of multinationals—with the aid of Madison Avenue advertising—have utterly confused the picture of the national origin of products. For example, Ford's Pinto has been heralded as the U.S. answer to imported small cars. But the engines are imported from England and Germany, and the standard transmissions are imported from Europe.

"This phenomenon is far different from the development of corporations here in America during the last 100 years. The multinational is not simply an American company moving to a new locality where the same laws apply and where it is still within the jurisdiction of Congress and the Government of the United States. This is a runaway corporation, going far beyond our borders. This is a runaway to a country with different laws, different institutions, and different labor and social standards. In most instances, even the name changes.

"Ironically these are the same multinational corporations who have sought to influence U.S. trade legislation in the name of 'free trade.'

"Meanwhile, back in the United States, expansion of large national corporations has been tempered to a degree by Government regulations, standards, and controls. And, in the past few decades, large U.S. corporations have had to meet responsibilities to their employees through labor unions. Moreover, the multinationals' global operations are beyond the reach of present U.S. law or the laws of any single nation."

The Business Defense

On the other side, defenders of multinational corporations claim that rather than export jobs, multinational corporations help create jobs in the United States, make us more competitive in international markets and improve our balance of payments position.

Former Secretary of Agriculture, Orville Freeman, who is currently President of "Business International" stated before the Subcommittee;

"By definition, a multinational company is one that looks at the entire world as an area of operation, and acts that way. It searches everywhere in the world for new technology, talented people, new processes, raw materials, ideas and capital. It thinks of the entire world as its market and it strives to serve customers everywhere. It produces goods or renders services wherever they can be economically produced or rendered to serve one or more markets at a profit.

"These international companies have demonstrated great dynamism and adaptive power in responding to what might be described as an emerging world economy—the product of modern communication and transportation, which has shrunk the world from the size of a balloon to the size of a grape. Figures are less than exact, but the most solid estimates indicate that the level of production of multinational corporations has reached $450 billion (more than the GNP of any country in the world other than the United States), of which the United States multinational companies deliver an estimated $213 billion a year. This level of output by American companies outside the United States is more than four times U.S. exports. It rests on an investment of $140 billion and carries a net worth of approximately $70 billion. It returned to the United States in 1970 through dividends, interest, royalties, and fees $7,040 million. Its net contribution to our balance of payments for 1970 at $3,040 million was $1,500 million more than the merchandise export surplus. It would have been double this figure if records of exports to subsidiaries had been kept after 1965, when such exports amounted to $4,420 million.

"Internationalization of production of this magnitude has come about because it's effective. It works. It involves a major extension of the economies of scale and management, involving high levels of capital and advanced organization skills which make possible the efficient use of science and technology. The growth rate of production by international corporations has been high and remarkably steady since 1950, at a level of 10 percent. This compares with a noninternationalized output rise in the western developed countries at a much more modest rate of 4 percent."

Another defender of international corporations, Dr. N. R. Danielian, President of the International Economic Policy Association, commented:

"The multinational corporations are caught in the contradictions of our policies in defense, aid, and trade. Their alleged sins are now being decried among academicians, certain spokesmen of labor and even in ministerial conferences in Europe. These corporations are accused of exporting jobs; but they seldom receive credit for the jobs they create from exports—as in fact they produce one-fourth of the total U.S. exports with their shipments to their overseas affiliates.

"The implication that 'run-away' U.S. companies serve the U.S. market with cheap, foreign labor simply is inaccurate in all but a few cases. To take one example: Of the 1,321,000 foreign cars imported during 1970, only 123,299, or 9.3 percent, were made by U.S. subsidiaries abroad. The rest were Volkswagens, Toyotas, Fiats, and the like, all produced by foreign-owned companies. In the case of the 13 million short tons of iron and steel imported during 1970, hardly any could be attributed to American-owned subsidiaries abroad.

"If all U.S. investments abroad were suddenly eliminated, the United States would be worse off by nearly $17 billion in its international receipts, two-thirds in exports and one-third in investment income, not including the $1.5 billion income from royalties and fees. As sympathetic as I am to labor's viewpoint in the matter of employment, I sincerely believe that they are whipping the wrong horse in attacking international or multinational corporations. Most of our imports come from foreign-owned enterprises; and if third country markets could not be supplied by U.S. subsidiaries abroad, they would simply be supplied by foreign competitors.

"European opinion tends to blame U.S. direct investments for the balance of payments deficits. Everyone talks about the $30 billion of American investments in Europe, two-thirds of which are direct and one-third are in portfolio investments, roughly speaking; but it is rarely mentioned that European investments in the United States are about equal—some $29.5 billion—even though more of theirs are in portfolio investment.

"Many people, who should know better, blame American companies for the recent currency crisis. Multinational corporations are in the business of manufacturing and selling products, not gambling with huge cash reserves. They would not be in business long if they speculated with a magnitude of liquid assets which could shake the foundations of the combined central banks of Europe."

Concern Abroad

If the economic effects of multinational corporations are a contentious issue at home, the political effects are an explosive issue abroad. From Ottawa to Montevideo and Paris, "statesmen" have raised questions as to whether the activities of multinational corporations are actually another from of American "economic imperialism." Questions of national control over means of production go to the very heart of the political process, a fact which we may not fully appreciate in this country.

In Europe the concern expressed in the phrase "the American Challenge" ("le defi Americain") may well result in a common industrial policy aimed at curtailing the strength of the American multinationals.

Canada has recently adopted stricter controls over the inflow of equity capital, as well as restricted the the export of oil from American-owned companies to the oil starved mid-west of the United States.

Japan has long controlled foreign investment in their country. They have preferred to borrow the foreign money needed to acquire technology without allowing outside participation in their industry.

Latin America has a growing hostility to foreign investment particularly from the Colossus of the North.

While we may view those corporations as "multinational", foreign countries view them often as an extension of American influence and dominance which they may not consider in their own national interests. The very reasons why these corporations are viewed by their defenders at home as being in the United States interests, are used by their critics abroad as being against foreign national interests.

There are those who claim that multinational corporations are an engine for world peace which break down national barriers and create a world economy based upon entangling interrelationships which will make all countries act not only in consideration of their own national interests but out of concerns for their international interests. Thus, multinational corporations who are champions of free trade may be at least as concerned about actions which could jeopardize their assets abroad as they are about their production in the United States.

Yet, it should be recognized that "multinationals" are not a distinctly American phenomenon. Royal Dutch/Shell, Volkswagenwerk, Philips Electric, British Petroleum, Shell Oil, Imperial Chemical, British Steel, Nippon Steel, Hitachi, Siemens, Farbwerke Hoechst and Daimler Benz are a few of the prominent foreign multinational companies who are competing for a share of the multinational market. These "foreign multinationals" are often government-owned or at least heavily subsidized by their governments.

In the light of all that has been said—the accusations and counter-accusations—wherein lies the truth? There are probably no definitive answers to the many issues raised by multinational corporations. The Tariff Commission has completed an in-depth study of "multinationals." The Commission study revealed many diverse effects of the operations of these companies.

Summary of Tariff Commission Study on Multinational Corporations

Why U.S. Firms Invest Abroad.—The study found that capital moved abroad because of the market growth potential in developed countries or the threat of being denied access to foreign markets through exports. Cost factors according to the study, were secondary except in the case of such industries as consumer electronics, footwear, toy, and apparel, where the search for low-wage labor was a major factor in decisions to invest abroad. Foreign tax incentives and subsidies, combined with impediments to trade were also significant inducements to invest abroad.

Effect on Jobs in the United States.—To measure the impact of foreign investment on domestic employment between 1966 and 1970, the study, using Commerce Department data, made three alternative assumptions of "what would have happened" if multinationals had not taken their capital abroad:

(1) The most "pessimistic" estimate, according to the Commission, assumes that if there were no U.S. plants abroad, foreign countries would not replace the output of those U.S. plants with local production, but would import the entire output from the United States. Under these assumptions, the presence of U.S. plants abroad represents a net *loss* of 1.3 million jobs;

(2) A second estimate assumes that foreign countries would replace half the output of their U.S. plants from their own production and import the remainder from the U.S. Under these circumstances there is a net *loss* of 400,000 U.S. jobs.

(3) A third estimate was based on what the Commission deemed more realistic assumptions than the other two, namely, that in the absence of U.S. MNC's, foreigners would not have substituted their own plants for those of the MNC's but that U.S. exports could reasonably be expected only to have maintained the shares of world exports of manufactures that they held in 1960–61, rather than to have taken completely all the markets served abroad by the MNC's affiliates. Under these assumptions, the net employment effect in manufacturing shows a *gain* of roughly half a million U.S. jobs.

The study notes that the effect of foreign investment on domestic employment varied from industry to industry, with employment being increased in some industries and either unaffected or reduced in others.

Effect on World Trade and Capital Formation.—Multinationals exerted a significant influence on world trade and on capital formation in host countries. In seven countries surveyed—the United Kingdom, France, West Germany, Belgium-Luxembourg, Canada, Mexico, and Brazil—U.S.-based multinationals in 1970 accounted for 13 percent of all capital spending, and 22 percent of the capital spending in the industrial "backbone" sectors—metals, machinery, and transport equipment.

Effect on U.S. Trade.—The Commission found a close association between the U.S. foreign investment and U.S. exports, but a weak association between the level of foreign investment and the degree of penetration by foreign imports. Overall, the Commission found that U.S. multinationals generated $3.4 billion more in new exports than in new imports. Non-MNC firms in manufacturing produced

$3.6 billion more in new imports than in new exports. Again, the study points out the substantial variance in these effects, industry by industry. Of the 24 industries in which comparisons could be made between 1966 and 1970, there were sixteen industries showing net increases in U.S. exports of $7.3 billion, and eight industries showing net decreases in U.S. exports of $3.4 billion.

Balance of Payments Effect.—Multinationals apparently made a major, positive contribution to the current account of the U.S. balance of payments and were not a factor in the deterioration of the basic balance of payments deficit during the late 1960's. The study points out that transactions with Canada and Japan have been the chief factors in the deterioration of the U.S. balance of payments position. Multinationals were a factor in the adverse history of balance of payments with Canada, but not with respect to Japan.

Effect on the International Monetary System.—The Commission's study of the role of multinationals in the international monetary system found that private corporations at the end of 1971 controlled some $268 billion in short-term liquid assets, with the lion's share controlled by multinational firms and banks headquartered in the U.S. Movement of only a small portion of the $268 billion could produce massive monetary crises. The study points to the creative role MNC's have played in the development of the international money market, but also that such firms and banks could, without any destructive or predatory motivations, frustrate a country's monetary policy because of the mobility of short-term capital. Interest rate differentials or rumors of a currency revaluation, for example, could send billions of dollars or other currencies from one country seeking to maintain low interest rates for employment reasons to another—seeking to maintain high interest rates to assuage inflationary pressure.

Technology, R&D, and the Multinational Firm.—Multinational corporations based in the United States dominate the development of new domestic technology, according to the study. Exports of technology outweigh imports by a factor of more than ten to one. The study found that while high technology industries have tended in recent years to put more new direct investment abroad, compared with investment at home, these industries have been prominent generators of high technology exports from the United States but have not been prominent generators of high technology imports to the United States. Between 1966 and 1970, according to the study MNC's in the high technology industries generated some $6.1 billion in net new exports while the non-MNC's in the same industries generated about $2.1 billion in net new imports.

Legal Issues.—The study foresees potential conflicts arising from the extra-territorial application of antitrust laws and other policies. It points out that United States antitrust laws are based on a philosophical premise that a truly competitive economic system is the most efficient and most desirable form of society, but that this view is not necessarily shared by America's trading partners and competitors. The European, Canadian, and Japanese approaches, the study suggests, favor combination and cartelization of domestic enterprises in order to compete effectively with the powerful United States-based multinationals.

Dimensions of Multinational Firms

It is not surprising that the Commission study concluded that technologically-advanced industries showed a large net gain in employment while the less technologically-advanced tended to show no gain or even losses, since the overall trade performance of the United States is heavily dependent on "high technology industries" and the job impact of foreign investment depends heavily on the trade performance of those industries.

It is difficult to generalize about the activities and effects of multinational corporations because they encompass quite a diverse and heterogeneous group of companies. These activities may range from making thimbles in Mexico to exploring for oil off the coast of Nigeria; from wholly-owned U.S. subsidiaries to plants in which the U.S. ownership is only 10 percent; from factories to sales outlets. In a word, "multinationals" are not only different animals according to their diverse operations, but also because of their degree of ownership and control, size, extension, geographic distribution, management philosophies and many other variables.

While these companies are heterogeneous there is no doubt but that they are big. (See table 1 on the following page.)

If General Motors were a nation its "economy" would be the 23rd largest in the world, with Standard Oil (New Jersey) and Ford not far behind.

The "book value" of U.S. investments abroad has increased from $31.9 billion in 1960 to $86 billion in 1971. Table A in the Appendix and the charts below break down U.S. investment abroad by industry and area over the 1960–1971 period. The "book value" measurement is known to understate the real value of U.S. corporate assets abroad. The total asset value of U.S. investment abroad, including short term assets, is estimated at $203 billion with manufacturing accounting for $78 billion and petroleum at $44 billion.

Europe has surpassed Canada as the main area for U.S. investments abroad with U.S.-owned private assets there in excess of $80 billion compared with $43 billion in Canada and $24 billion in Latin America.

The worldwide sales of foreign manufacturing affiliates of U.S. firms exceed $90 billion, almost three times the value of U.S. exports of manufactured products. These sales are over half the total exports of manufactured products from all O.E.C.D. nations. (See Table 2).

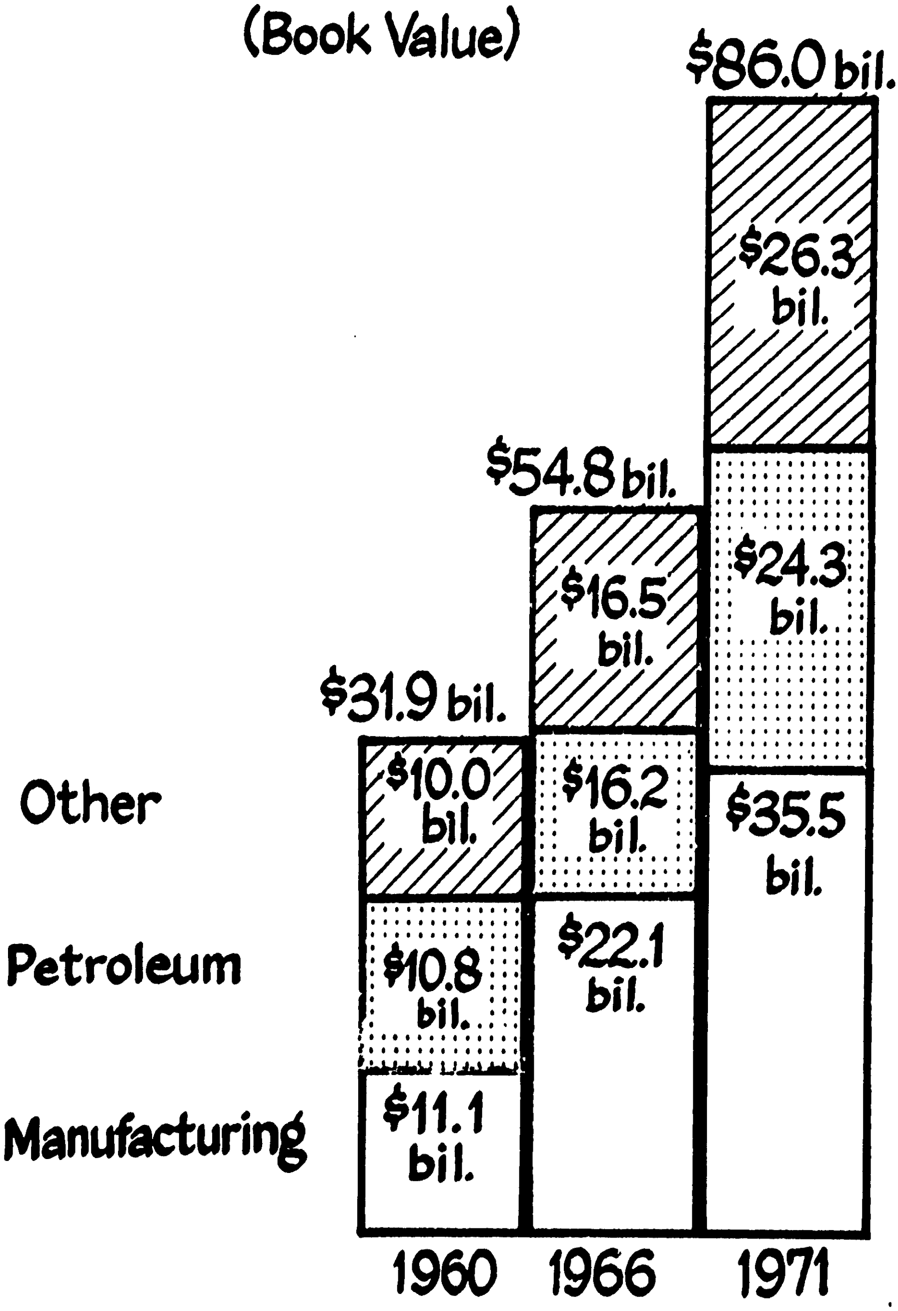
TABLE 1.—NATIONS AND CORPORATIONS

One way to show the size of today's large multinational corporations is to compare their gross annual sales with the gross national products of countries. This table uses 1970 figures for all except the centrally planned economies (excluding China) and General Motors Corp., for which 1969 figures are used. The amounts are shown in billions of dollars.

1. United States	$974.10
2. Soviet Union	504.70
3. Japan	197.18
4. West Germany	186.35
5. France	147.53
6. Britain	121.02
7. Italy	93.19
8. China	82.50
9. Canada	80.38
10. India	52.92
11. Poland	42.32
12. East Germany	37.61
13. Australia	36.10
14. Brazil	34.60
15. Mexico	33.18
16. Sweden	32.58
17. Spain	32.26
18. Netherlands	31.25
19. Czechoslovakia	28.84
20. Romania	28.01
21. Belgium	25.70
22. Argentina	25.42
23. GENERAL MOTORS	24.30
24. Switzerland	20.48
25. Pakistan	17.50
26. South Africa	16.69
27. STANDARD OIL (N.J.)	16.55
28. Denmark	15.57
29. FORD MOTOR	14.98
30. Austria	14.31
31. Yugoslavia	14.02
32. Indonesia	12.60
33. Bulgaria	11.82
34. Norway	11.39
35. Hungary	11.33
36. ROYAL DUTCH/SHELL	10.80
37. Philippines	10.23
38. Finland	10.20
39. Iran	10.18
40. Venezuela	9.58
41. Greece	9.54
42. Turkey	9.04
43. GENERAL ELECTRIC	8.73
44. South Korea	8.21
45. IBM	7.50
46. Chile	7.39
47. MOBIL OIL	7.26
48. CHRYSLER	7.00
49. UNILEVER	6.88
50. Colombia	6.61
51. Egypt	6.58
52. Thailand	6.51
53. ITT	6.36
54. TEXACO	6.35
55. Portugal	6.22
56. New Zealand	6.08
57. Peru	5.92
58. WESTERN ELECTRIC	5.86
59. Nigeria	5.80
60. Taiwan	5.46
61. GULF OIL	5.40
62. U.S. STEEL	4.81
63. Cuba	4.80
64. Israel	4.39
65. VOLKSWAGENWERK	4.31
66. WESTINGHOUSE ELEC.	4.31
67. STANDARD OIL (Calif.)	4.19
68. Algeria	4.18
69. PHILIPS ELECTRIC	4.16
70. Ireland	4.10
71. BRITISH PETROLEUM	4.06
72. Malaysia	3.84
73. LING-TEMCO-VOUGHT	3.77
74. STANDARD OIL (Ind.)	3.73
75. BOEING	3.68
76. DUPONT	3.62
77. Hong Kong	3.62
78. SHELL OIL	3.59
79. IMPERIAL CHEMICAL	3.51
80. BRITISH STEEL	3.50
81. North Korea	3.50
82. GENERAL TELEPHONE	3.44
83. NIPPON STEEL	3.40
84. Morocco	3.34
85. HITACHI	3.33
86. RCA	3.30
87. GOODYEAR TIRE	3.20
88. SIEMENS	3.20
89. South Vietnam	3.20
90. Libya	3.14
91. Saudi Arabia	3.14
92. SWIFT	3.08
93. FARBWERKE HOECHST	3.03
94. UNION CARBIDE	3.03
95. DAIMLER-BENZ	3.02
96. PROCTOR & GAMBLE	2.98
97. AUGUST THYSSEN-HUTTE	2.96
98. BETHLEHEM STEEL	2.94
99. BASF	2.87

Source: Lester Brown, "The Interdependence of Nations."

U.S. Direct Investments Abroad by Major Industry
(Book Value)



U.S. Direct Investments Abroad by Area (Book Value)

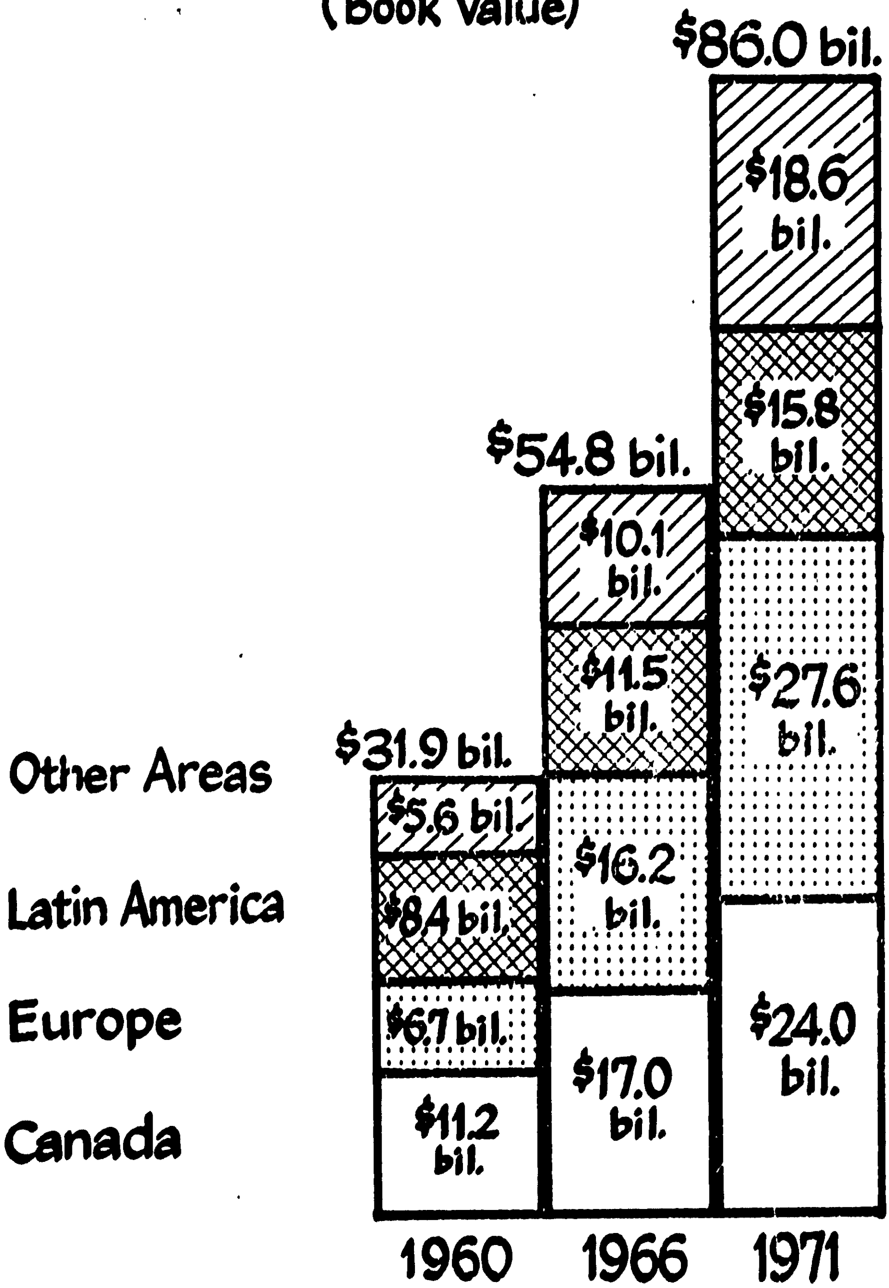


TABLE 2.—COMPARISONS OF SALES OF FOREIGN MANUFACTURING AFFILIATES OF U.S. FIRMS WITH OECD EXPORTS AND U.S. EXPORTS, 1961–70

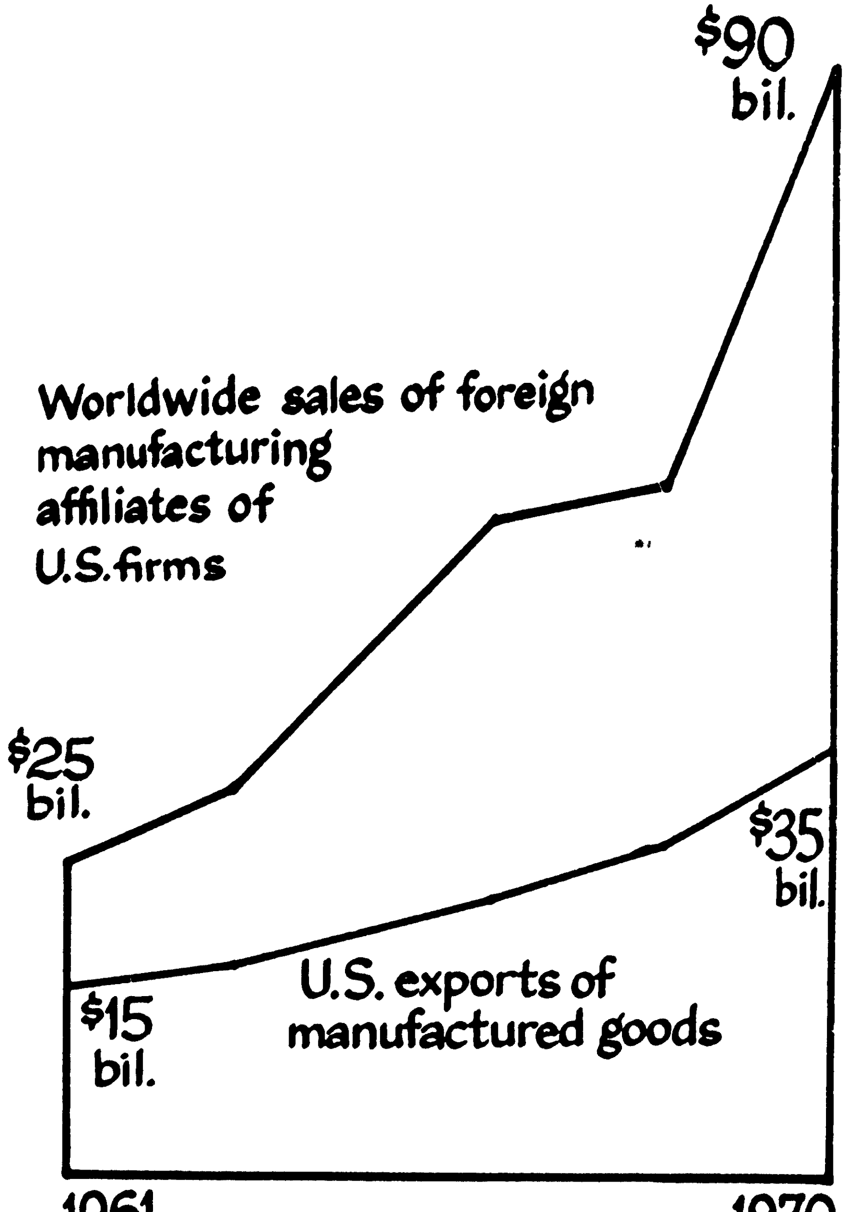
[In millions of dollars]

	Values					Average annual growth (percent)	
	1961	1963	1966	1968	1970[1]	1961–70	1966–70
Worldwide sales of foreign manufacturing affiliates of U.S. firms	25,061	31,809	53,681	59,676	90,431	15.3	13.9
OECD exports of manufactured goods	([2])	([2])	107,751	120,692	176,209	([2])	13.1
U.S. exports of manufactured goods (FAS)	15,083	16,990	22,406	27,547	34,971	9.8	11.8

[1] Estimated.
[2] Not available.

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, International Investment Division; OECD trade statistics; and Trade Relations Council of the U.S., average.

Comparison of U.S. Exports of Manufactured Goods and Sales of Foreign Affiliates of U.S. Firms



Profits

The profits of multinational corporations are truly diversified. The table below shows the profits of 50 major U.S. companies in 1970 which derived over $400 million or over 40 percent of their total revenues from overseas. The effective devaluation of the dollar (the second devaluation in slightly over one year) will increase the dollar value of foreign earnings.

Only two corporations, Standard Oil of New Jersey and IBM, earned $500 million abroad in 1970. Seven others made over $100 million. Surprisingly, Ford Motor and General Motors did not make more profits abroad than ITT, even though the automotive giants are $900 million to $1.2 billion larger.

Large diversified multinational corporations with earnings spread out all over the globe in various industries are in a better position to avoid large cyclical fluctuations in their earnings because of a recession in any particular country. This indeed has been the case with U.S. multinationals. With a slowdown in the U.S. economy in 1970, overseas profits really buoyed the earnings of many U.S. companies.

One of the issues related to overseas profits is the question of whether the U.S. foreign source income provisions give an incentive to invest abroad rather than at home.

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Table 3.—MULTINATIONAL PROFITS, 1970

Company	Net sales (millions)	Estimated foreign sales (millions)	Percent total	Net income (millions)	Percent foreign	Where the profits come from
Standard Oil (New Jersey)	$16,554	$8,277	50	$1,310	52	Worldwide.
Ford Motor	14,980	[1] 3,900	26	516	[1] 24	Germany, Britain, Australia.
General Motors	18,752	[1] 3,563	19	609	[1] 19	Worldwide.
Mobil Oil	7,261	3,267	45	483	51	Canada, Middle East.
International Business Machines	7,504	2,933	39	1,018	50	Worldwide.
International Telephone & Telegraph	6,365	[1] 2,673	42	353	[1] 35	Canada, Europe, Latin America.
Texaco	6,350	2,540	40	822	([2])	Worldwide.
Gulf Oil	5,396	2,428	45	550	[3] 21	Middle East, South America, Canada.
Standard Oil of California	4,188	1,885	45	455	[3] 46	Middle East, Indonesia, South America.
Chrysler	7,000	[1] 1,700	24	[4] 7.6	([2])	Worldwide.
General Electric	8,727	1,393	16	329	20	South America, Canada, Italy.
Caterpillar Tractor	2,128	1,118	53	144	([2])	Export sales, Worldwide.
Occidental Petroleum	2,402	[1] 1,105	46	175	([2])	Middle East, South America, Africa.
F. W. Woolworth	2,528	[5] 1,001	35	77	61	Canada, Germany, Britian.
Eastman Kodak	2,785	874	31	404	19	Worldwide.
Union Carbide	3,026	870	29	157	([2])	Do.
Procter & Gamble	3,178	795	25	238	25	Britain, Europe, Latin America.
Singer	2,125	775	37	75	([2])	Europe, Latin America.
Dow Chemical	1,911	771	40	103	[6] 45	Worldwide.
CPC International	1,376	692	50	61	51	Do.
International Harvester	2,712	680	25	52	([2])	Canada, Europe, Africa.
Firestone Tire & Rubber	2,335	677	29	93	39	Worldwide.
Colgate-Palmolive	1,210	670	55	40	([2])	Do.
Honeywell	1,921	622	35	58	([2])	Europe, British Commonwealth.
National Cash Register	1,421	643	45	30	[6] 51	Worldwide.

E. I. du Pont	3,618	634	18	329	(2)	Export sales, Europe.
W. R. Grace	1,938	633	33	30	[1,6] 39	Latin America.
Minnesota Mining & Manufacturing	1,687	605	36	188	(2)	Europe, Canada, Australia.
First National City Corp	1,704	600	35	139	40	Worldwide.
Englehard Minerals & Chemical	1,474	589	40	36	(2)	Britain, Europe, Japan.
Sperry Rand	1,739	589	34	72	(2)	Europe, Japan.
Xerox	1,719	518	30	188	38	Britain, Canada, Latin America.
American Standard	1,418	511	36	13	33	Europe.
Coca-Cola	1,606	498	31	147	(2)	Worldwide.
Swift	3,076	492	16	29	(2)	Canada, Britain, Germany.
General Foods	2,282	479	21	119	(2)	Canada.
American Smelting & Refining	718	467	65	89	[7] 55	Australia, Peru, Mexico.
Monsanto	1,972	467	24	67	31	Canada, Latin America, Europe.
Warner-Lambert	1,257	453	36	98	(2)	Worldwide.
General Telephone & Electronics	3,439	441	13	236	7	Canada, Europe, Latin America.
H. J. Heinz	990	433	44	38	44	Worldwide.
Uniroyal	1,556	420	27	24	75	Canada, Mexico.
Pfizer	870	412	47	81	55	Britain, Europe, Latin America.
Litton Industries	2,404	409	17	69	(2)	Europe, Latin America.
Schlumberger	579	341	59	49	(2)	France, Canada.
Otis Elevator	[3] 601	301	50	24	35	Worldwide.
Gillete	673	289	43	66	50	Do.
USM	440	203	46	10	98	British Commonwealth, Europe, Latin America.
Chesebrough-Pond's	261	111	43	21	40	Europe, Canada, Latin America.
Black & Decker	255	107	42	20	50	Export sales.

[1] Excludes Canada.
[2] Not available.
[3] Contracts completed.
[4] Deficit.
[5] Percent based on consolidated sales and equity in unconsolidated subsidiary.
[6] Percent based on operating income.
[7] Percent based on earnings before taxes and extraordinary items.

Note: All oil company figures exclude excise taxes.

The Tax Issues

There are, to be sure, incentives in the United States Internal Revenue Code to encourage investment abroad. During the nineteen fifties private investment abroad was encouraged by the United States Government as an adjunct to our foreign aid program. We extolled the virtues of the "free enterprise system" and wanted to export that philosophy to other nations. We encouraged the transfer of technology through our technical assistance and foreign aid programs to the extent that we increased plant capacity abroad in the very areas which were later to provide us with concentrated import competition.

The Foreign Tax Credit

Our tax laws provide that foreign subsidiaries of United States corporations may credit their foreign taxes paid against the income tax liability of the parent corporations on foreign source income. This was considered necessary to avoid "double taxation" that is, taxation by the host country and taxation by the United States Government on the same income. The multinational corporations will argue that foreign governments provide not only tax neutrality with regard to their own multinational corporations but will actually give them outright subsidies and tax forgiveness. They will also point out that if they are denied the ability to compete abroad through the establishment of plants, foreign corporations will fill the breech and will export their products back to the United States; thus, our labor situation will not be improved and our balance of payments will be made much worse.

On the other hand, however, critics will point out that the foreign tax credit not only serves to encourage (or at least not discourage) American corporations from setting up their factories abroad, but it will also tend to erode the United States tax base. This is because foreign governments preempt the substantial portion of the income of these companies and thereby reduce the tax liabilities of their parent corporations to the United States Treasury. They may suggest that it was the foreign tax credit not the depletion allowance or any of the other so-called tax preferences, which was responsible for the fact that several large United States corporations paid little or no domestic income tax in some recent years. Furthermore, there is the question of whether the parent company can juggle the books, so to speak, so as to arrange their world-wide income distribution to minimize the United States tax liability.

The credit for income taxes paid abroad dates from 1918; it was designed to eliminate double taxation of income. Prior to that time a deduction from gross income had been allowed for foreign income taxes.

Prior to 1921, only American corporations with foreign branches were entitled to the foreign tax credit. In 1921, Congress extended the foreign tax credit to a domestic corporation which owned a majority of voting stock in a foreign subsidiary. In general, the credit continued unchanged until 1942 when Congress expanded it to allow domestic corporations a credit for taxes paid by a wholly owned foreign subsidiary of the majority owned foreign subsidiary. In 1951, Congress further liberalized this provision by allowing the tax credit to a domestic corporation which owns at least 10 percent of the voting stock of a foreign subsidiary from which it receives dividends.

It also provided that such a 10 percent owned corporation which owns 50 percent or more voting stock in another foreign corporation, from which it receives dividends, shall be regarded as having paid a portion of the taxes paid by the other foreign corporation in any foreign country.

In 1921, the limitation was based on the foreign tax payments which could be allowed as a credit against United States tax. This was the "overall" limitation which restricted the credit so that it would not exceed the same proportion of the total U.S. tax, as the income from foreign sources bears to the total income of the taxpayer. This limitation was imposed to prevent the U.S. tax on domestic income from being reduced by foreign rates which are higher than U.S. rates.

In 1932, the Congress added a "per country" limitation, which specifies that, with respect to taxes paid to each country, the credit should not exceed the proportion of the U.S. tax which the taxpayer's income from within such country bears to his entire net income. This limitation was written in to eliminate a tax benefit received by some taxpayers deriving income in more than one country as compared with the taxpayers operating in only one country. Both of these limitations were in effect until the 1954 Code eliminated the overall limitation.

Table 4 shows that the taxable income on foreign earnings of U.S.-owned corporations was $11 billion in 1970. Taxes paid to foreign governments on that income is estimated at $5.7 billion, or 51.8 percent. After crediting those foreign taxes with a $4.6 billion foreign tax credit, the U.S. Government received only $640 million on the $11 billion in taxable income or 6 percent.

TABLE 4.—DATA ON U.S. CORPORATIONS WITH TAXABLE INCOME FROM FOREIGN SOURCES: ALL INDUSTRIES, MANUFACTURING, AND MINING

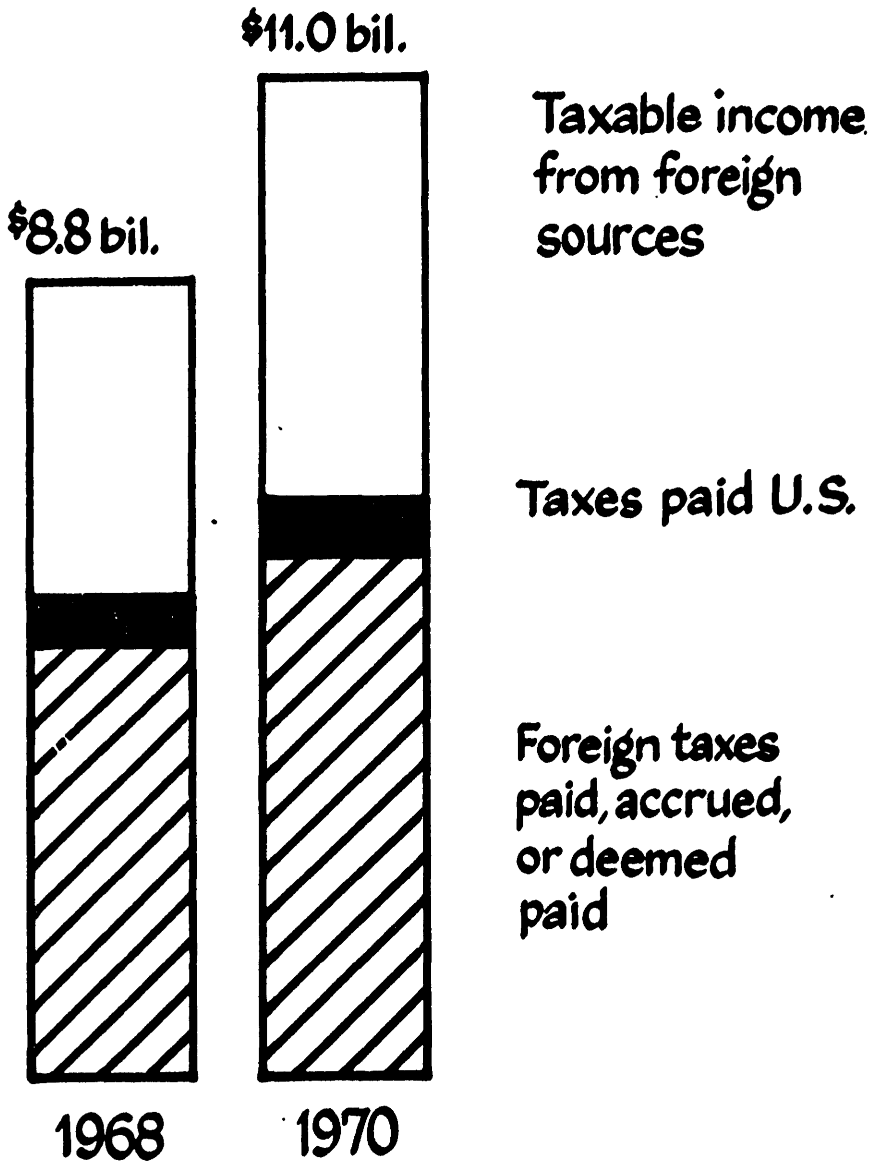
[In millions of dollars]

	All industries		Manufacturing [1]		Mining [2]	
	1968	1970	1968	1970	1968	1970
Taxable income from foreign sources	8,760	[3] 11,000	6,096	[3] 7,700	1,262	[3] 1,085
Foreign taxes paid, accrued, or deemed paid	4,525	[3] 5,680	3,198	[3] 4,040	845	[3] 725
Foreign tax credit claimed	3,656	4,640	2,603	3,398	642	701
Taxes paid to U.S. Government on foreign source income	[3] 550	[3] 640	[3] 325	[3] 300	none	none

[1] Includes petroleum refining.
[2] Includes crude petroleum.
[3] Estimated.

Source: Actual data from an unpublished IRS tabulation for 1968 tax year. Estimates provided by Joint Committee on Internal Revenue Taxation.

Taxable Income from Foreign Sources and Taxes Paid



If the credit is eliminated, companies argue, the U.S. would receive considerably more, but the effective tax rate on these corporations would increase to the 70–75 percent range, which could make them uncompetitive in foreign markets.

On the other hand, if foreign investment erodes, over time, the industrial base in the United States, it also erodes our tax base and ultimately our high standard of living. Then it might reasonably be asked "Who is going to pay for the cost of government?"—the needs of our cities, social insurance programs, our defense posture *et al.*? Wage and salaried individuals are already heavily taxed. Without a strong manufacturing sector they would not have the income to pay for the existing government services, no less new programs. That is a fundamental issue that underlies some of the provisions in the Hartke-Burke bill.

One might also ask if the collection of only about 6 percent of foreign taxable income is worth all the complexity of "Subpart F" of the Code?

The Deferral Issue

Another related tax issue is the deferral aspect of foreign-source income. Under our tax laws, a subsidiary abroad may defer the payment of United States taxes until such time as the income is repatriated back to the United States. They do not pay as United States citizens who earn a salary or wage must pay their taxes—on a current basis. This deferral aspect, is in effect, an interest-free loan to United States subsidiaries abroad which again can be manipulated to the advantage of the parent company.

Are these incentives in the Tax Code in the best United States-national interest? If not, can they be modified without raising the issue of double taxation which ending the foreign tax credit would certainly do. These are questions that the Congress will have to face.

Multinationals and the U.S. Trade Performance

The United States sustained the largest trade deficit in its history in 1972. Measured on an f.o.b., balance of payments basis, the trade deficit was $6.9 billion; measured on a c.i.f. (and excluding foreign aid exports) the deficit was $14.5 billion, an amount larger than our total balance of payments deficit on any basis of measurement.

The 1972 deficits are said to be attributable mainly to:

(1) The rapid growth in the U.S. economy in 1972, giving rise to a large increase in the demand for imports;

(2) The "perverse" effects of the dollar devaluation in December 1971 which increased the value, but not always the volume, of U.S. imports;

(3) The growing value of raw materials imports particularly petroleum, and

(4) The failure of our trading partners to provide meaningful access to their markets for U.S. products.

There are always explanations for a disaster and clearly 1972 was a disaster for the U.S. trade position.

The Tariff Commission study, based upon Commerce Department data, concluded that U.S.-based multinationals were a positive factor in our trade account and were not responsible for the deterioration in the balance of trade between 1966 and 1970, years in which data on MNC's are available.

Manufactured exports related to multinational corporations increased from $13.7 billion in 1966 to $21.7 billion in 1970, and account for about 62 percent of total U.S. exports. (See table 5). Imports of manufactures from U.S. MNC's rose from $6.1 billion in 1966 to $10.7 billion in 1970, accounting for 35 percent of U.S. imports of manufacturers.

Multinational Corporations Account for a Greater Proportion of Manufactured Exports than Imports

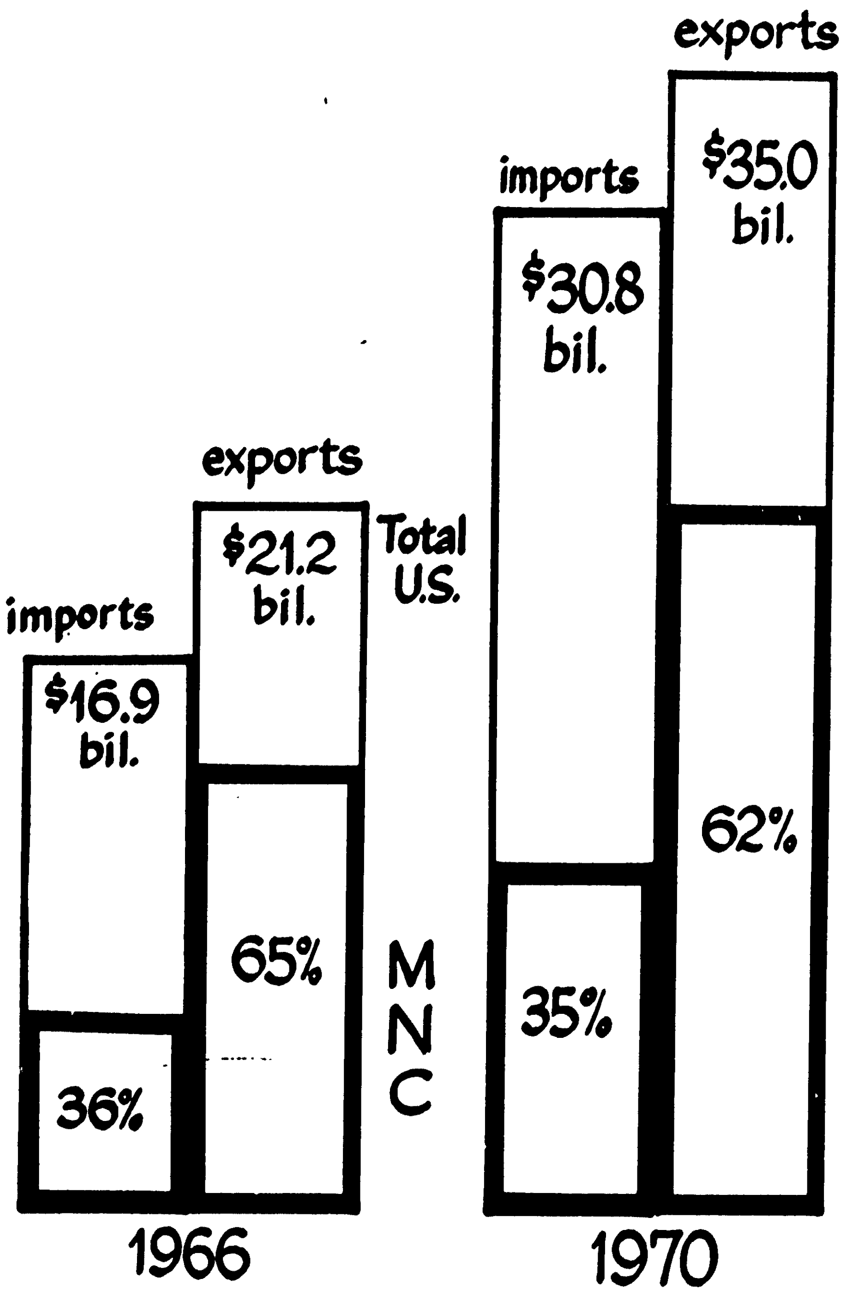


TABLE 5.—MNC-RELATED U.S. TRADE IN MANUFACTURING COMPARED WITH TOTAL U.S. TRADE, 1966 AND 1970

[Amounts in millions of dollars]

	U.S. exports		U.S. imports	
	Total	MNC-related	Total	MNC-related
All manufacturing:				
1966	21,227	13,692	16,893	6,073
1970	34,969	21,718	30,795	10,702
Chemicals and allied products:				
1966	2,677	1,956	957	640
1970	4,012	2,342	1,256	807
Primary and fabricated metals:				
1966	1,781	1,142	3,267	372
1970	3,749	2,237	4,715	513
Machinery and transport equipment:				
1966	11,162	7,839	4,828	2,256
1970	17,463	12,605	12,089	5,414
All other industries:				
1966	5,607	2,755	7,841	2,805
1970	9,745	4,534	12.735	3,968

Examination of these data may lead to the conclusion that all is well in trade in manufactures—we have an apparent surplus and the MNC's are responsible for it. Not so!

The U.S. competitive position in manufactures has deteriorated rapidly in recent years as the following table indicates. Import data for the United States have been adjusted to a c.i.f. basis (roughly 10 percent higher than fob data) to make them comparable to data of our trading partners. The table below showing U.S. trade in manufacturers compared with that of our major trading partners is revealing: it shows that the U.S. trade in manufactures deteriorated from a surplus of $5 billion in 1960 to a deficit of $7 billion in 1972. Even more dramatic were the tremendous increases in the surpluses of two of our main competitors—West Germany and Japan. West Germany's surplus in manufactured goods reached $16.4 billion in 1972, while that of Japan climbed to the astounding figure of $19 billion. Thus, while U.S.-based multinationals may show a positive balance of trade, the Nation as a whole is losing markets to Germany and Japan.

Balance of Trade in Manufactures

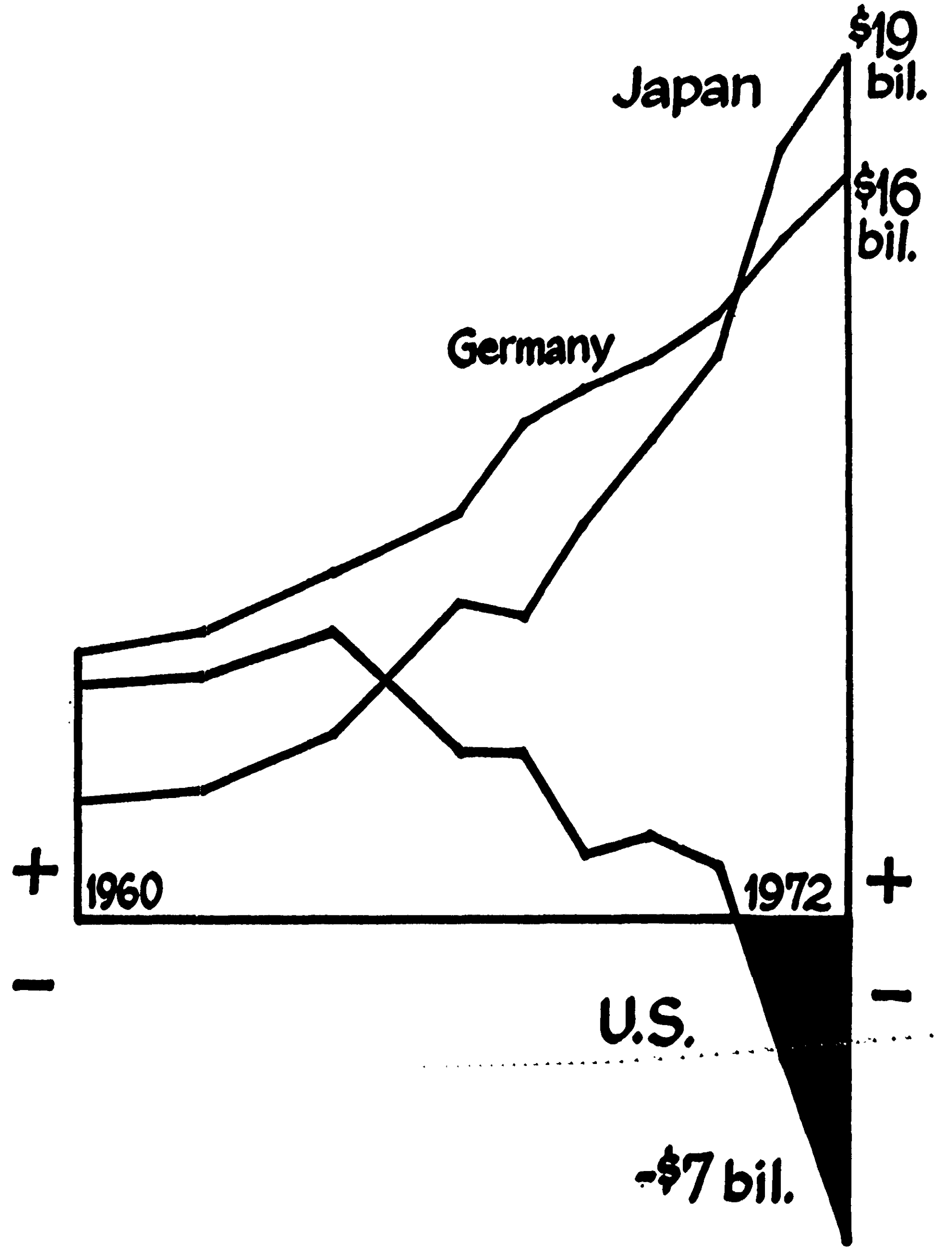


TABLE 6.—TRADE IN MANUFACTURES 1960-72

[In billions of dollars]

	United States	EEC Total	EEC Excluding Intra-EEC	Germany	United Kingdom	Japan
Exports, f.o.b:						
1960	12.7	23.1	16.1	10.1	8.4	3.6
1966	19.5	42.0	24.6	18.0	12.3	9.1
1967	21.2	44.9	26.6	19.5	12.1	9.8
1968	24.1	51.6	29.9	22.3	13.0	12.2
1969	27.1	61.2	33.6	26.2	15.0	15.0
1970	29.7	71.6	38.6	30.7	16.3	18.1
1971	30.8	79.5	43.4	35.0	19.0	22.6
1972 [1]	33.4	87.5	46.8	39.6	20.0	25.7
Imports, c.i.f.:						
1960	7.5	13.6	6.6	4.2	4.0	1.0
1966	15.8	28.8	11.6	9.0	6.9	2.1
1967	17.4	29.6	11.7	8.5	7.8	3.1
1968	22.7	34.9	13.6	10.6	9.1	3.5
1969	25.3	44.6	17.2	13.9	9.9	4.4
1970	28.5	53.4	20.7	17.4	11.0	5.6
1971	33.8	57.4	21.8	20.0	12.7	5.5
1972 [1]	40.5	63.1	23.3	23.2	14.8	6.7
Trade balance:						
1960	5.2	9.5	9.5	5.9	4.4	2.6
1966	3.7	13.2	13.0	9.0	5.4	7.0
1967	3.7	15.3	14.9	11.0	4.3	6.7
1968	1.4	16.7	16.3	11.7	3.9	8.7
1969	1.8	16.6	16.4	12.3	5.1	10.6
1970	1.2	18.2	17.9	13.3	5.3	12.5
1971	–3.0	22.1	21.6	15.0	6.3	17.1
1972 [1]	–7.1	24.4	23.5	16.4	5.2	19.0

[1] January-September at annual rate.

Source: U.S. Department of Commerce, "International Economic Indicators," December 1972, p. 14.

In the United States, exports account for between 11–14 percent of production of goods while in the Federal Republic of Germany the ratio is about 38 percent, in France 24–30 percent, the U.K. 45–48 percent, Japan about 30 percent, and Canada 67 percent as the table below indicates:

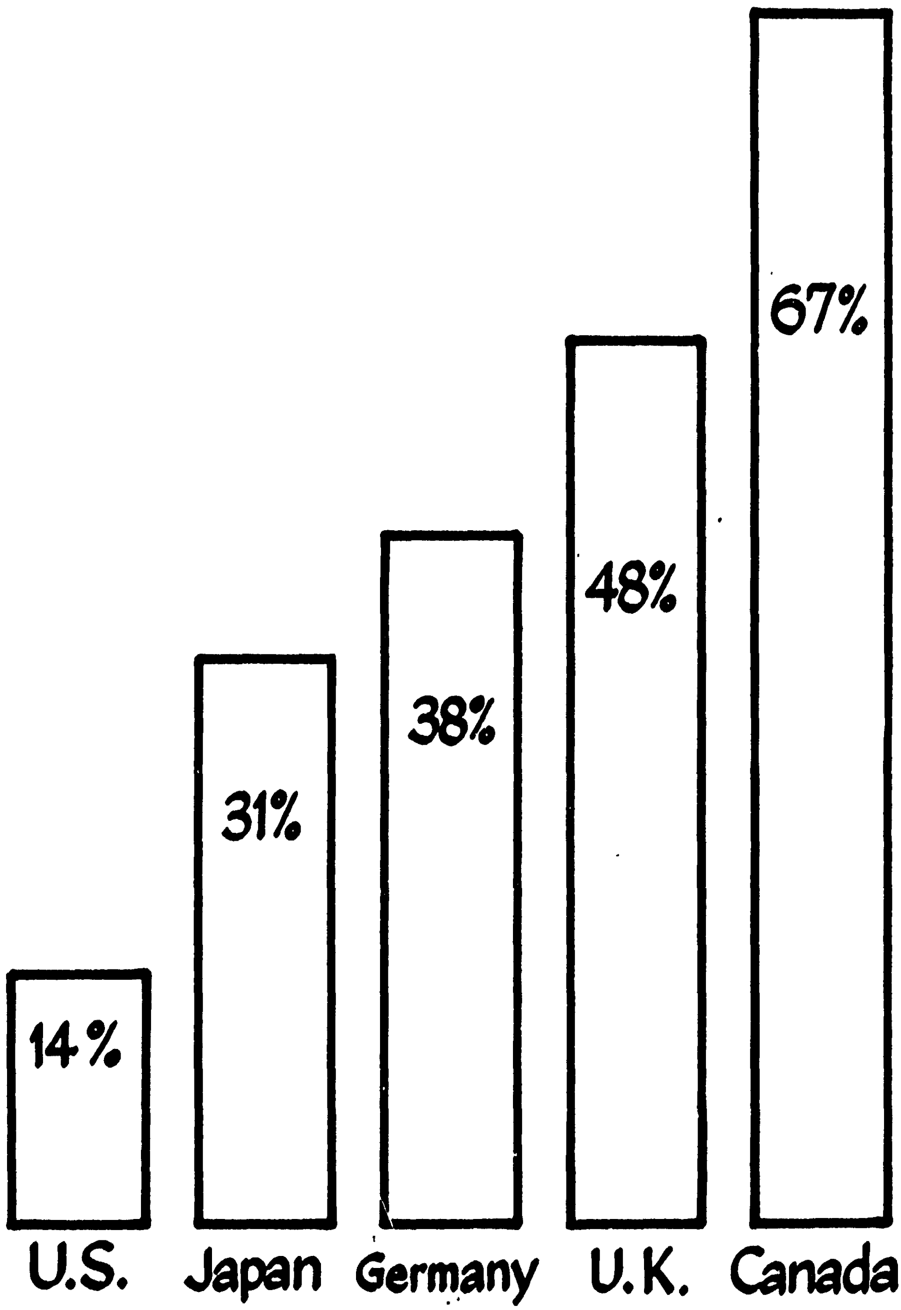
TABLE 7.—COMPARATIVE RATIOS OF EXPORTS TO PRODUCTION OF GOODS

	United States	Federal Republic of Germany	France	United Kingdom	Japan	Canada
1960	11.1	31.3	23.4	38.5	24.9	45.1
1966	11.4	34.7	23.7	40.6	30.1	54.5
1967	11.7	38.0	23.2	39.1	26.3	60.0
1968	11.9	39.7	24.4	44.9	27.7	66.0
1969	12.4	38.6	26.0	48.5	30.1	66.8
1970	14.2	37.9	29.7	48.5	31.1	(1)

1 Not available.

Source: U.S. Department of Commerce "International Economic Indicators".

Exports as a Percentage of Total Production of Goods



Employment in Manufacturing

It is said that the United States is becoming more and more a "service" economy. The table below bears that out. Manufacturing employment in the United States has not increased significantly over the postwar period, while employment in "wholesale and retail" trade, and "services" has, as well as "State and local" government employment. As our labor force (wage and salary workers) increased steadily from 40.4 persons in 1945 to 72.8 million in 1972, employment in manufacturing increased from 15.5 million to only 18.9 million over this period.

Does this suggest that the United States is entering a post-industrial era in which manufacturing industries in the United States will not be able to absorb the 20 million new entrants expected in the labor force by 1980?

Can a nation remain in a leadership position in the world without a strong industrial base?

With the anticipated huge increases in petroleum imports, estimated to cost $20-25 billion by 1980, how can the United States expect to balance its international accounts when it is losing competitiveness in manufactured exports?

Nonagricultural Employment in the U.S.

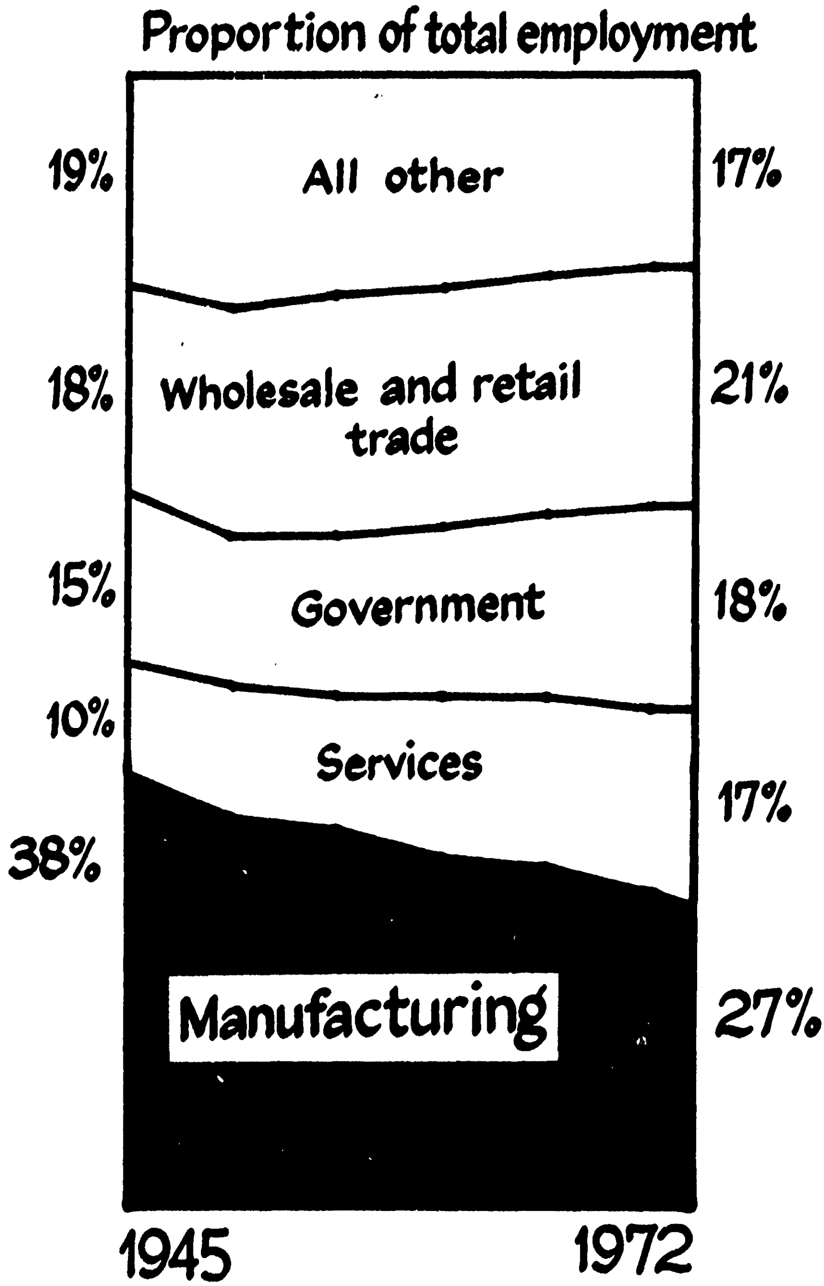


TABLE 8.—EMPLOYMENT IN THE UNITED STATES IN NONAGRICULTURAL ESTABLISHMENTS DURING THE POSTWAR ERA 1945–72

[In millions of persons]

	Total wage and salary workers	Manufacturing		Mining	Construction	Transport public utilities	Wholesale and retail trade	Finance, insurance, and real estate	Services	Government	
		Total	Percent of total employment							Federal	State and local
1945	40.4	15.5	38	0.8	1.1	3.9	7.3	1.5	4.2	2.8	3.1
1950	45.2	15.2	34	.9	2.3	4.0	9.4	1.9	5.3	1.9	4.1
1955	50.7	16.9	33	.8	2.8	4.1	10.5	2.3	6.3	2.2	4.7
1960	54.2	16.8	31	.7	2.9	4.0	11.4	2.7	7.4	2.3	6.1
1965	60.8	18.1	30	.6	3.2	4.0	12.7	3.0	9.1	2.4	7.7
1970	70.6	19.4	27	.6	3.4	4.5	14.9	3.7	11.6	2.7	9.8
1972	72.8	18.9	27	.6	3.5	4.5	15.7	3.9	12.3	2.6	10.6

Source: "Economic Report of the President", January 1973, p. 227.

Multinational Corporations and the Dollar Crisis

The United States has just experienced the second massive run on the dollar in the past 18 months.

The underlying causes of these all too frequent episodes is the persistent deficit in the U.S. balance of payments which, cumulatively, over the period 1950–1972 totals over $88.6 billion. The basic causes of U.S. payments deficits are not U.S. foreign investment, as will be explained later, but more fundamental forces in the world economy and the assumption by the U.S. government of massive political, military, and economic aid responsibilities around the globe.

Clearly, however, whatever the fundamental causes, there is a glut of American dollars in Europe and Japan. The speculators are capable of not only frustrating a nation's monetary policy but also of literally forcing a devaluation or re-valuation on countries. Perhaps there is a positive aspect to this as the speculators end up forcing governments to do what they should have done but for questions of national esteem and political stake resist doing.

Nevertheless, the huge dollar holdings of American corporations, and overseas branches of American banks can trigger off massive monetary crises. Short term assets of foreign affiliates of U.S. corporations totaled $110 billion in 1971, while foreign banks and foreign branches of U.S. banks held another $114 billion in short term assets. The Tariff Commission study estimates the amount of short-term funds that may have been capable of flowing across national boundaries, generating international monetary crises as $162 billion in 1969, $212 billion in 1970 and $268 billion in 1971. (See Table 9).

TABLE 9.—ESTIMATED SHORT-TERM ASSET AND LIABILITY POSITIONS OF PRINCIPAL INSTITUTIONS IN INTERNATIONAL MONEY MARKETS, 1971

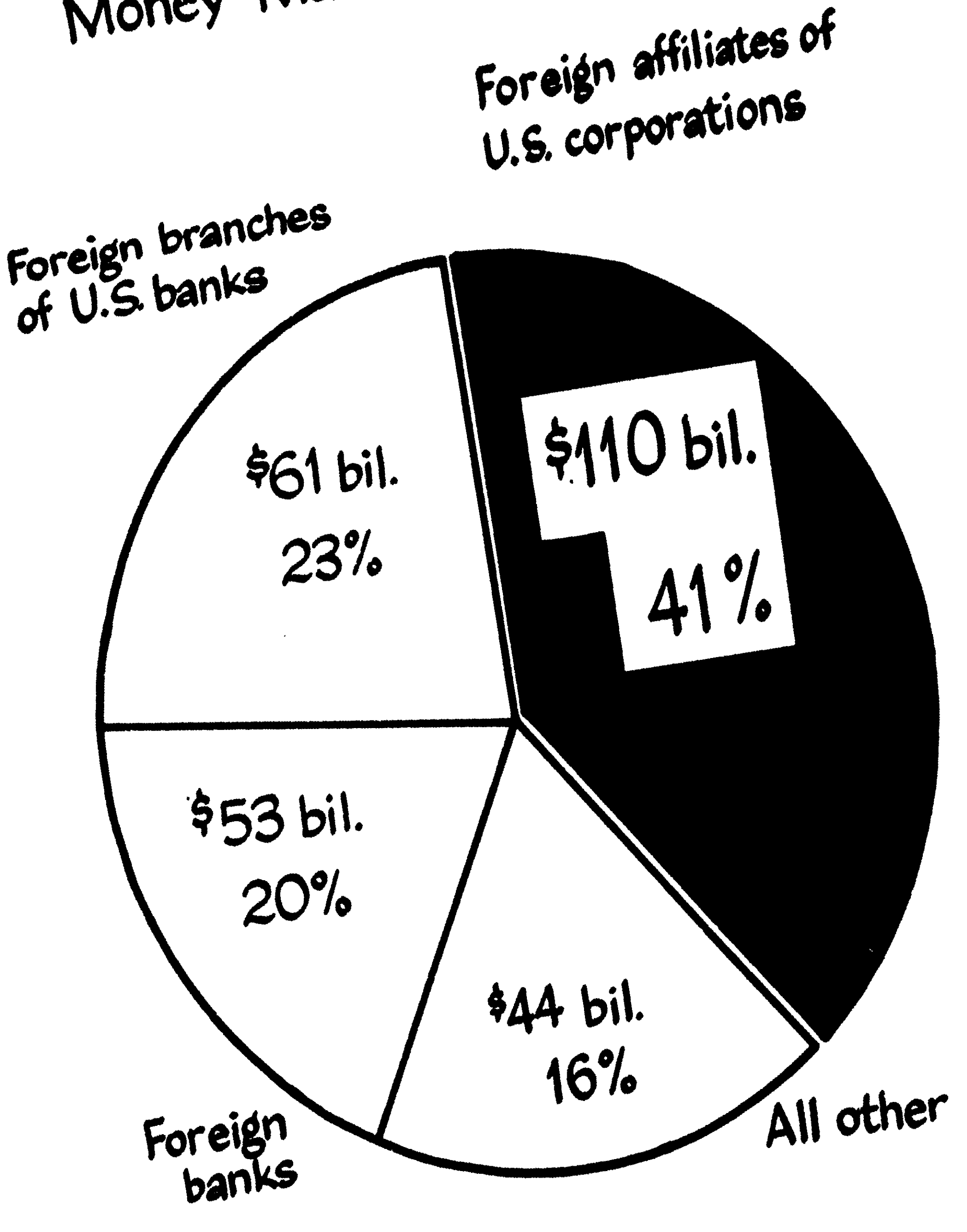
[Billions of U.S. dollars]

	Assets	Liabilities
U.S. banks	13.0	16.0
U.S. nonbanks	5.2	2.6
Foreign banks	52.7	46.5
Foreign governments, central banks, and international organizations	18.7	(1)
Foreign nonbanks	6.8	11.4
Foreign affiliates of U.S. corporations	110.0	63.0
Foreign branches of U.S. banks	61.4	61.5
Total	267.8	201.0

[1] Not available.

Source: Tariff Commission, "Implications of Multinational Corporations for World Trade and Investment and for U.S. Trade and Labor," p. 537.

Short-term Assets in International Money Markets, 1971



Total: $268 bil.

TABLE 1C.—U.S. TRADE AND BALANCE-OF-PAYMENTS DEFICITS 1960–72

[In billions of dollars]

	U.S. trade position				Trade balance		Balance of payments		
	Exports (X)		Imports (M)						
	Total	Minus foreign aid	F.o.b.	C.i.f. [1]	F.o.b.	C.i.f. (M) Excluding foreign aid(X)	Liquidity [4]	Official settlements	Basic balance
1960	19.6	18.0	14.7	16.2	4.9	1.8	−3.7	−3.4	[2]−0.8
1961	20.2	18.5	14.5	16.0	5.7	2.5	−2.3	−1.3	
1962	21.0	18.9	16.2	18.0	4.8	.9	−2.9	−2.7	
1963	22.4	19.8	17.0	18.6	5.4	1.2	−2.7	−1.9	
1964	25.7	22.9	18.6	20.6	7.1	2.3	−2.7	−1.5	
1965	26.7	24.1	21.5	23.5	5.2	.6	−2.5	−1.3	
1966	29.3	26.7	25.5	28.1	3.8	−1.4	−2.2	.2	−1.7
1967	30.6	28.1	26.8	29.5	3.8	−1.4	−4.7	3.4	−3.3
1968	33.6	30.1	33.0	36.0	.6	−5.9	−1.6	−1.6	−1.4
1969	36.4	35.2	35.8	39.4	.6	−4.2	−6.1	2.7	−3.0
1970	42.0	40.8	39.8	43.8	2.1	−3.0	−3.9	−10.7	−3.1
1971	42.8	40.8	45.5	50.1	−2.7	−9.3	−22.0	−30.5	−9.3
1972	48.7	46.7	55.6	61.2	−6.9	−14.5	[3]−13.1	−10.1	[3]−10.2

[1] C.i.f. imports are assumed to be roughly equivalent to 110 percent of f.o.b. imports, in accordance with a Tariff Commission study. The actual c.i.f. import values will be published monthly beginning in July 1973.
[2] Average.
[3] January–September 1972.
[4] The liquidity deficit for 1966–1972 excludes SDR allocations.

Source: U.S. Department of Commerce, "Survey of Current Business" December 1972 and earlier issues.

The Tariff Commission study points out:

"This $268 billion, all managed by private persons in a private market which is virtually uncontrolled by any sort of official institution, amounts to more than twice the total of all international reserves held in central banks and international monetary institutions in the world at the same date. These are reserves with which central banks fight to defend their exchange rates. *The resources of the private sector outclass them.*" (Emphasis supplied)

This report was written before the latest dollar crisis. Yet, it speaks with admirable clarity on the current events.

There is no doubt that the international monetary system rests on shaky foundations. It would be unfair to attribute the underlying cause of the all too frequent monetary crisis either to the "gnomes of Zurich," or to the greed of international corporate money managers. As the Tariff Commission study indicates:

"While it is not appropriate to conclude that speculative behavior characterizes the international financial activities of the great majority of MNC's, it is appropriate to stress that they have been a primary creative force in the growth of international money and capital markets."

The Eurocurrency market, with its large privately held dollar and other currency holdings has contributed to the growth of trade and investment, particularly in Europe. But the existence of large pools of dollars all over the world overshadows the ability of central banks to maintain fixed exchange rates. One of the questions which the monetary authorities will have to face is that: "given the mobility of enormous private holdings of convertible currencies, should exchange rates be forced to change under crisis circumstances, or should they (i.e., the monetary authorities) adopt objective, internationally-agreed-upon criteria to facilitate periodic changes in currency values to reflect changed economic circumstances?"

The underlying causes of the recurrent international monetary crisis are the chronic deficits in the U. S. balance of payments, which have flooded the world with unwanted dollars, and the inadequate international monetary and trading rules which do not facilitate adjustment of nation's deficits and surpluses.

The causes of the persistent U.S. balance of payments deficit are not simple: they go deep to the heart of the changed economic relationships in the postwar period which are due, in large measure, to the political and military role assumed by the United States to protect the freedom of others, while the countries we protected concentrated on developing highly technologically advanced and competitive economic structures, which they protected from outside competition in various ways. Foreign investment by U.S. corporations cannot be fairly blamed as the basic cause of our persistent balance of payments deficits. Indeed, the income on foreign investment is growing at a healthy pace, and together with royalty and fee income, exceed direct investment capital outflows by $4.5 billion, as the table and chart following indicate.

Financial Flows Related to Direct Investment, 1971

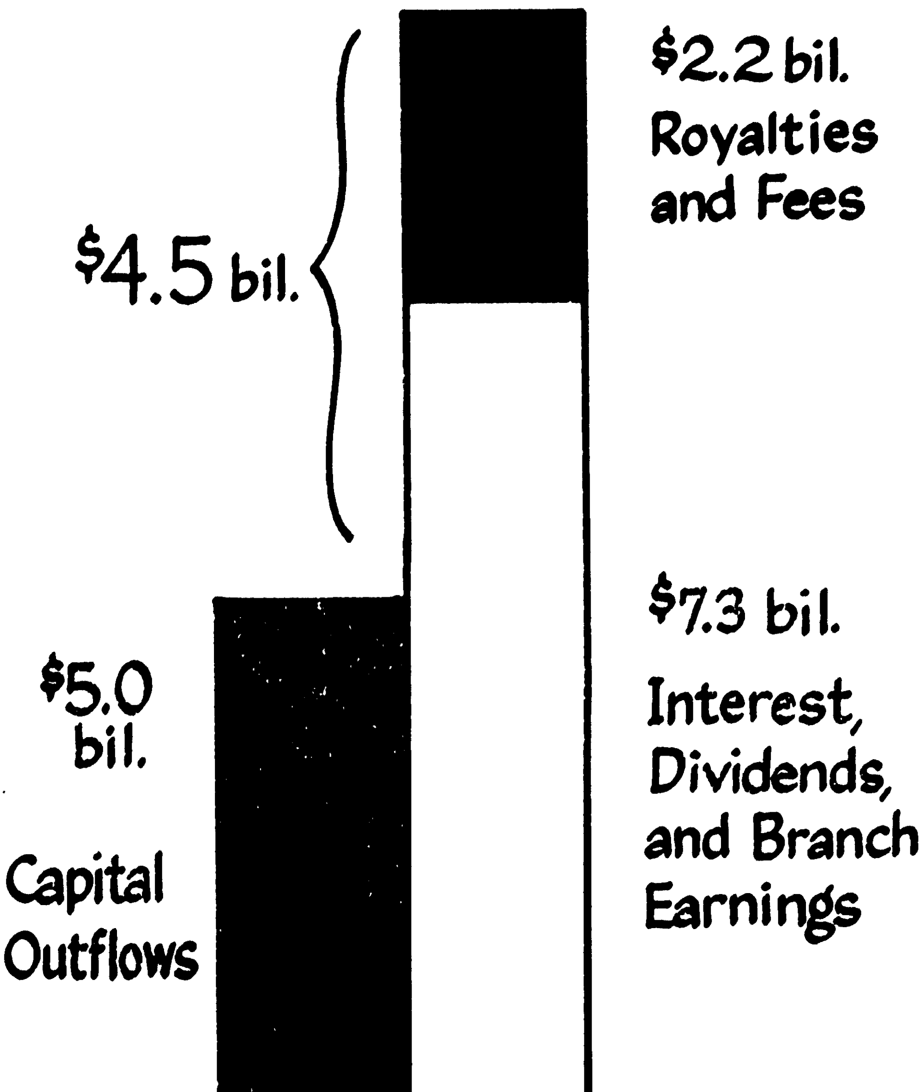


TABLE II.—SUMMARY OF FINANCIAL FLOWS RELATED TO DIRECT INVESTORS, 1964, 1970, 1971

[In millions of dollars]

	1964	1970	1971 [1]
Direct Investment Capital Outflows (total)	2,328	4,400	4,965
Manufacturing	1,034	1,295	1,468
Other	1,294	3,105	3,297
Interest, dividends, and branch earnings (net) (total)	3,674	6,001	7,286
Manufacturing	893	1,859	1,941
Other	2,781	4,142	5,345
Royalties and fees (net) (total)	1,013	1,919	2,169
Manufacturing	479	1,002	1,116
Other	534	917	1,053

[1] Preliminary.

Source: U.S. Department of Commerce, *Survey of Current Business*, November 1972.

From 1948 to 1970, Congress has appropriated over $150 billion for what is traditionally defined as foreign assistance. The Senate Appropriations Committee Report on "Foreign Assistance and Related Program Appropriations Bill, 1973" states that: "We know that these figures (i.e., the $150 billion) represent only a fraction of total resource transfers and can estimate that the true cost of this unprecedented effort has been at least $100 billion more than has been reflected in appropriations for new obligational authority."

The table shown below taken from the Senate Appropriations Committee report notes that the total transfer of U.S. resources to foreign nations is *$8.7 billion, $9.7 billion and $10.1 billion*, respectively, for fiscal years 1971, 1972, and 1973. (If the Export-Import Bank's lending program were included, those totals would become $11.6 billion, $17.0 billion and $17.5 billion.)

TABLE 12—TRANSFER OF U.S. RESOURCES TO FOREIGN NATIONS

	Fiscal year —		
	1971	1972	1973
Security assistance	+5,705,380,000	+6,236,805,000	+5,932,976,000
Development and humanitarian assistance	3,017,073,000	3,479,462,000	4,191,265,000
Grand total, foreign assistance	8,722,453,000	9,716,267,000	10,124,241,000
Export-Import Bank	2,880,800,000	7,331,800,000	7,331,800,000
Total (including Export-Import Bank)	11,603,253,000	17,048,067,000	17,456,041,000

In addition to our foreign assistance programs, the United States currently pays about 70 percent of the cost of defending the "Free World." To be sure, we benefit from our security shield, but it relieves other nations from costly expenditures which they would otherwise have to assume.

TABLE 13.—DEFENSE COSTS AND DEVELOPMENT ASSISTANCE

Country	Defense costs (1970)		Developmental assistance (1970)	
	(Millions of dollars)	Percent of GNP [1]	(Millions of dollars)	Percent of GNP [2]
United States	77,827	8.0	3,050	0.31
Portugal	[3] 400	6.3	28	.45
United Kingdom	5,767	4.9	447	.37
France	[3] 5,900	4.0	951	.65
Sweden	1,129	3.6	117	.37
Netherlands	1,096	3.5	196	.63
Australia	1,127	3.4	203	.59
Norway	[3] 375	3.4	37	.33
West Germany	6,103	3.3	599	.32
Belgium	695	2.8	120	.48
Italy	2,499	2.7	147	.16
Canada	1,906	2.4	346	.43
Denmark	368	2.3	59	.38
Switzerland	413	2.0	39	.14
Austria	[3] 165	1.2	19	.13
Japan	1,582	.8	458	.23

[1] Source: Economic Data Book for Countries of Europe, Statistics and Report Division, Agency for International Development, September 1971.
[2] Source: Organization for Economic Cooperation and Development as of June 28, 1971.
[3] Indicates estimate.

Staff note: Information not available as to how much foreign assistance rendered by France, Portugal, United Kingdom, the Netherlands, and Belgium is prior to colonies.

Source: Senate Appropriations Committee, "Foreign Assistance and Related Program Appropriations Bill, 1973."

While foreign investment by U.S. firms is not the underlying cause of persistent U.S. deficits, it is true that United States corporations have tended to produce for the large U.S. market and are not as dedicated to exporting as are their counterparts in Europe and Japan.

International Monetary Reform

"The United States, as do other nations, recognizes the need to reform and strengthen the framework for international trade and investment." The statement was made by Secretary Shultz on February 12 as the United States devalued the dollar for the second time in 18-months. His statement is reproduced in the Appendix. On September 26, 1972, the Secretary outlined the U.S. position on long-term reform of the international monetary system.

The international monetary "system" is indeed in a state of transition. The underpinnings of the Bretton Woods system, established at the Bretton Woods, New Hampshire conference in 1944, were pulled when President Nixon, on August 15, 1971, announced to the Nation his new economic program. The President's program had two interrelated objectives in mind: (1) to correct the overvaluation of the dollar to reestablish the competitiveness of U.S. products in world markets, and (2) to reform the international monetary system to ease the continuing burdens on the United States and to serve better the economic needs of the entire world.

In order to obtain these objectives, the President:

(1) Suspended the convertibility of the dollar into gold, special drawing rights, or other reserve assets and allowed the dollar to "float" in exchange markets;

(2) Imposed a 10 percent import surcharge on all dutiable imports;

(3) Excluded foreign capital equipment from the proposed tax credit for investment;

(4) Proposed the Domestic International Sales Corporation (DISC) to stimulate U. S. exports;

(5) Asked Congress to reduce foreign aid appropriations by 10 percent.

The Bretton Woods System

These actions abruptly altered the "rules of the game" for international financial dealings between nations established at Bretton Woods. Under the Bretton Woods system, all currencies were officially denominated in terms of gold, although they were actually pegged to the dollar. The dollar was fixed to gold, and convertible into gold by official monetary institutions.

The dollar became the world's currency, serving as the means for maintaining "par values," the reserve currency in central bank holdings, and as the standard of value for all currencies.

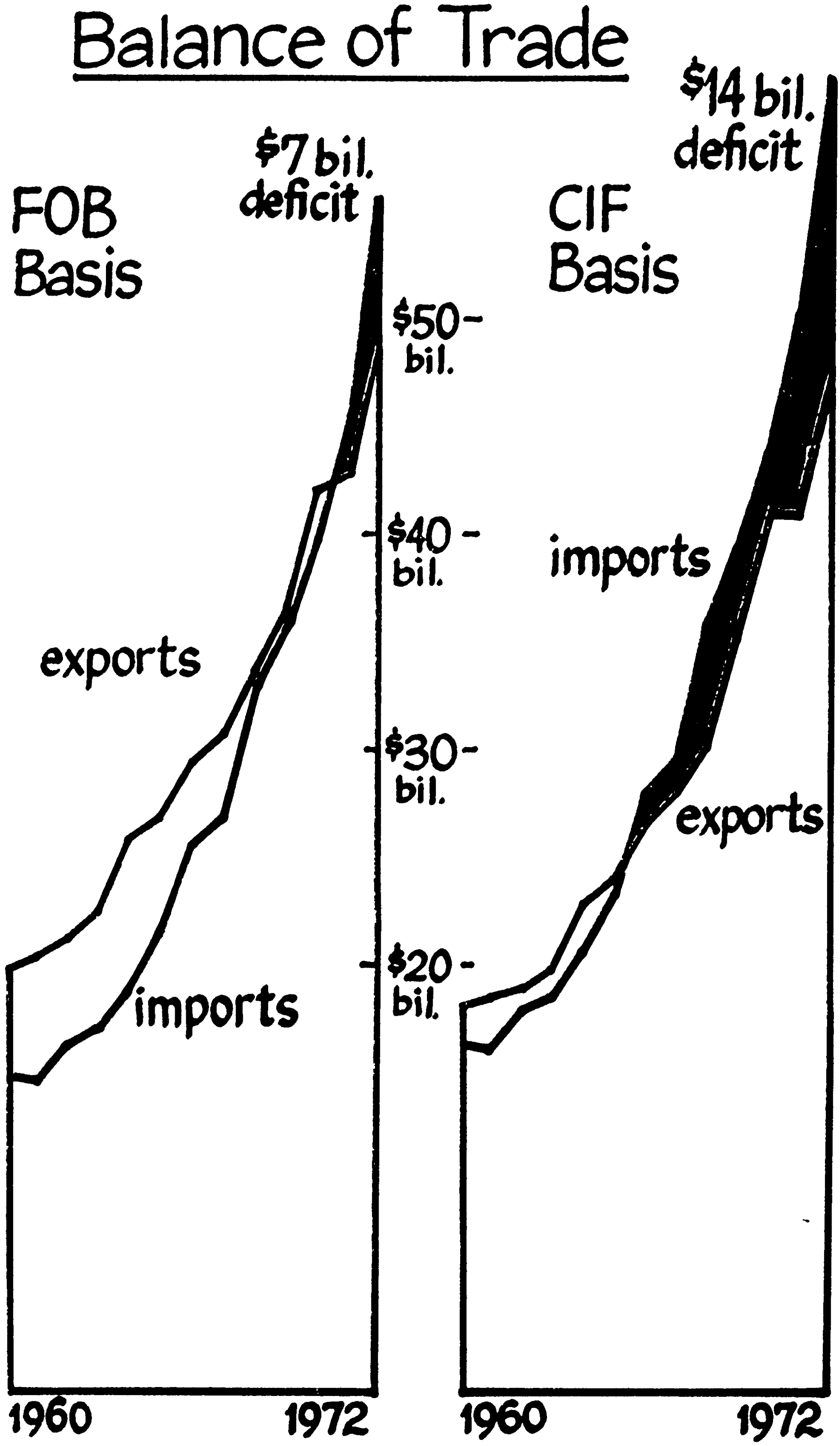
Because of its central role in the world economy and for reasons of prestige, the United States felt it could not devalue the dollar outright and sought solutions to its balance of payments problems in other ways. During the late fifties and all through the sixties, the United States acted to "correct" its balance of payments through piecemeal actions: tied aid, military offset sales, the Interest Equalization Tax, controls over bank lending and direct investment abroad, tightening Buy American requirements on Defense purchases, and other "cosmetic" actions, such as debt prepayments to make the numbers look better. Nothing really altered the fundamental changes in economic relationships and the deficits continued.

By the second quarter of 1971, no mere palliatives would improve our balance of payments deficits which were running at an over $20 billion annual rate. When those extraordinary deficits ballooned still further in the third quarter, running at over $40 billion annualized, accompanied by a massive run on the dollar, the President was forced to act on August 15, 1971.

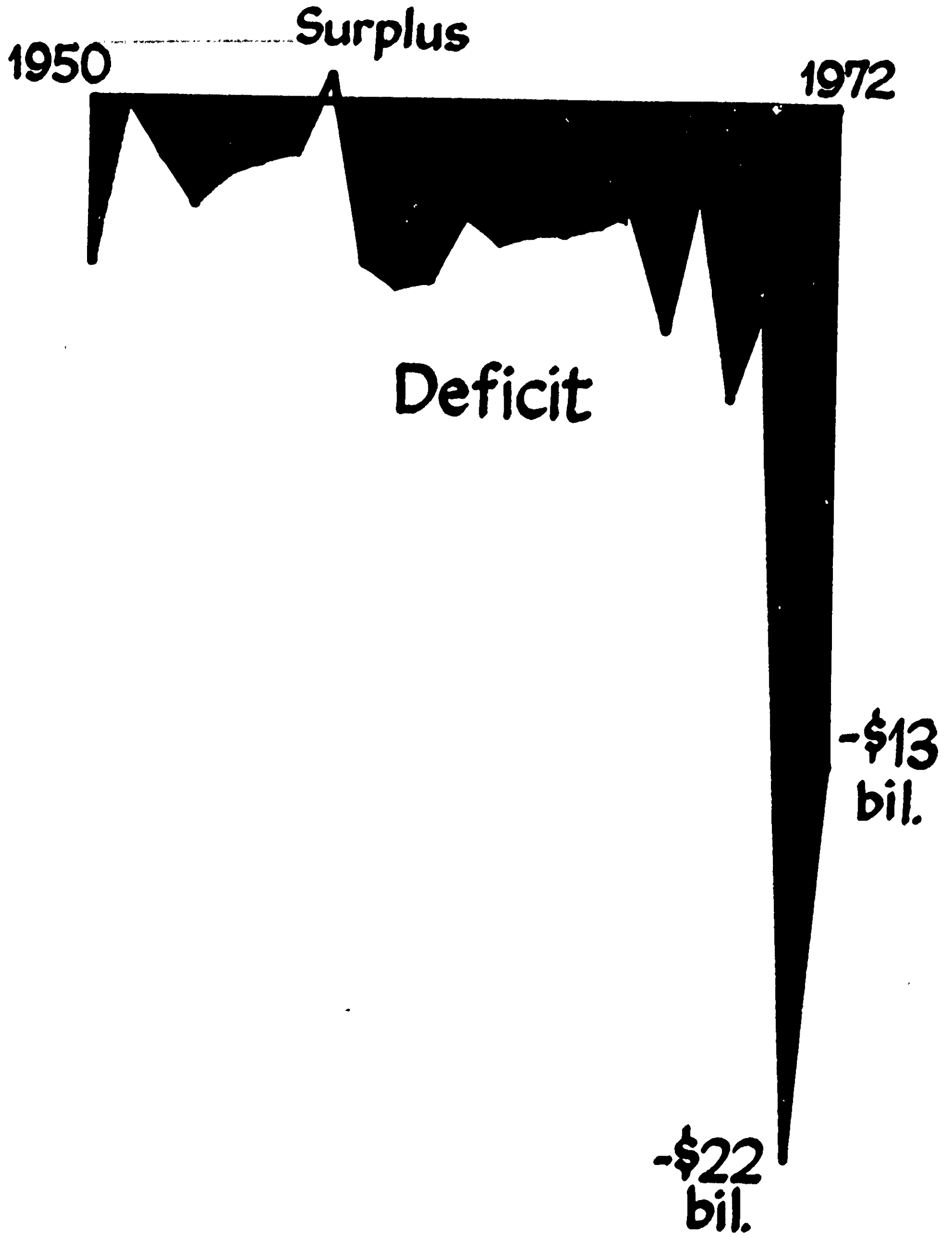
After a period of turmoil, new currency rates were set at the heralded "Smithsonian Agreement" in December 1971. All the official observers billed this realignment as an "historic" occasion and predicted a swing into the United States balance of trade and payments.

1972 did not witness any improvement, but rather a further deterioration in the U.S. trade and payments position, and by February 1973 another massive run on the dollar was upon us. The f.o.b. trade deficit shot up to $6.9 billion (balance of payments basis) while the c.i.f. trade deficit is estimated at the astounding level of $14.5 billion.

The unilateral devaluation of the dollar by 10 percent, and a float of certain other currencies such as the Japanese yen, the British pound, and the Italian lira, should result, over time, in a significant improvement in the U.S. competitive position. Imports of foreign products will become more expensive and U.S. exports will be more attractive in foreign markets. Yet, as the last devaluation showed, the short-term effects may well be negative. Furthermore, without a fundamental change in the rules governing international trade and finance, the international monetary system is likely to limp along from crisis to crisis and the deficit in the U.S. balance of payments could persist. The nations of the world face the alternatives of getting together to revamp the broken down Bretton Woods system in a cooperative way, or letting the law of the jungle take over in international trade and monetary matters.


Balance of Trade
FOB
Basis
$7 bil.
deficit
exports
imports
$50-
bil.
$40 -
bil.
$30-
bil.
$20 -
bil.
1960
1972
CIF
Basis
$14 bil.
deficit
imports
exports
1960
1972

Balance of Payments
(Liquidity Basis)



APPENDIX

TABLE A.—U.S. DIRECT INVESTMENTS ABROAD, BY AREA AND MAJOR INDUSTRY, 1960–71

[In millions of U.S. dollars]

	Book values							Value of total assets		Value of net fixed assets	
	1960	1962	1964	1966	1968	1970	1971 [1]	1966	1970 [2]	1966	1970 [2]
All areas (total)	31,865	37,276	44,480	54,799	64,983	78,178	86,001	124,792	203,076	43,937	69,012
Manufacturing	11,051	13,250	16,935	22,078	26,414	32,261	35,475	49,156	78,000	19,502	30,915
Petroleum	10,810	12,725	14,328	16,222	18,887	21,714	24,258	27,280	43,871	15,130	22,696
Other	10,004	11,301	13,757	16,499	19,682	24,203	26,268	48,356	81,205	9,305	15,401
Canada (total)	11,179	12,133	13,855	17,017	19,535	22,790	24,030	30,345	42,634	11,689	18,723
Manufacturing	4,827	5,312	6,198	7,692	8,568	10,059	10,537	12,587	16,514	4,957	6,945
Petroleum	2,664	2,875	3,196	3,608	4,094	4,807	5,134	5,369	8,355	3,707	6,531
Other	3,688	3,946	4,461	5,717	6,873	7,924	8,359	12,389	17,765	3,025	5,247
Europe (total)	6,691	8,930	12,129	16,233	19,407	24,516	27,621	49,959	80,367	15,070	22,517
Manufacturing	3,804	4,883	6,587	8,879	10,797	13,707	15,538	22,894	37,263	8,874	13,913
Petroleum	1,763	2,385	3,122	4,003	4,635	5,466	6,202	8,701	13,360	4,530	5,976
Other	1,124	1,662	2,420	3,351	3,975	5,343	5,881	18,364	29,744	1,666	2,628
Latin America (total)	8,365	9,524	10,254	11,498	13,101	14,760	15,763	20,081	23,996	7,621	8,643
Manufacturing	1,521	1,944	2,507	3,318	4,005	4,621	4,998	7,342	10,719	2,806	4,075
Petroleum	3,122	3,642	3,589	3,475	3,680	3,938	4,194	4,002	4,323	2,521	2,408
Other	3,722	3,938	4,158	4,705	5,416	6,201	6,571	8,737	8,954	2,294	2,160
Other areas (total)	5,630	6,689	8,242	10,051	12,940	16,112	18,587	24,407	56,079	9,557	19,129
Manufacturing	899	1,111	1,329	2,189	3,044	3,874	4,402	6,333	13,504	2,865	5,982
Petroleum	3,261	3,823	4,421	5,136	6,478	7,503	8,728	9,208	17,833	4,372	7,781
Other	1,470	1,755	2,492	2,726	3,418	4,735	5,457	8,866	24,742	2,320	5,366

[1] Preliminary.
[2] Estimated from sample data.

Source: Book values from U.S. Department of Commerce, "Survey of Current Business;" asset figures from data supplied to the U.S. Tariff Commission by U.S. Department of Commerce, Bureau of Economic Analysis, International Investment Division.

DEPARTMENT OF THE TREASURY,
Washington, D.C., February 12, 1973.

STATEMENT ON FOREIGN ECONOMIC POLICY BY SECRETARY OF THE TREASURY GEORGE P. SHULTZ

The United States, as do other nations, recognizes the need to reform and strengthen the framework for international trade and investment. That framework must support our basic objective of enhancing the living standards of all nations. It must encourage the peaceful competition that underlies economic progress and efficiency. It must provide scope for each nation—while sharing in the mutual benefits of trade—to respect its own institutions and its own particular needs. It must incorporate the fundamental truth that prosperity of one nation should not be sought at the expense of another.

This great task of reform is not for one country alone, nor can it be achieved in a single step. We can take satisfaction in what has been accomplished on a cooperative basis since the actions announced on August 15, 1971 clearly signaled our recognition of the need for decisive change.

Intense negotiations established an important fact in December 1971: mutual agreement can be reached on changes in the pattern of world exchange rates, including the parity of the United States dollar, in order to promote the agreed goal of a better balance in international trade and payments.

Monetary negotiations have been started by the "Committee of Twenty" on the premise that better ways must be found to prevent large payments imbalances which distort national economies, disturb financial markets, and threaten the free flow of trade. The United States has made practical and specific proposals for international monetary reform.

The groundwork is being laid for comprehensive trade negotiations. Those negotiations should look beyond industrial tariffs to encompass also other barriers to the free flow of goods. They should assure fair competitive treatment of the products of all countries. They should also seek agreed ways of avoiding abrupt dislocations of workers and businesses.

In September 1972 the President told the financial leaders of the world that "The time has come for action across the entire front of international economic problems. Recurring monetary crises, such as we have experienced all too often in the past decade; unfair currency alignments and trading arrangements, which put the workers of one nation at a disadvantage with workers of another nation; great disparities in development that breed resentment; a monetary system that makes no provision for the realities of the present and the needs of the future—all these not only injure our economies, they also create political tensions that subvert the cause of peace."

At the same meeting, I outlined the principles of a monetary system that would enable all nations, including the United States, to achieve and maintain overall balance in their international payments. Those principles would promote prompt adjustment and would provide equitable treatment for all nations—large and small, rich and poor.

Yet, in recent months we have seen disquieting signs. Our own trade has continued in serious deficit, weakening our external financial position. Other nations have been slow in eliminating their excessive surpluses, thereby contributing to uncertainty and instability. In recent days, currency disturbances have rocked world exchange markets. Under the pressure of events, some countries have responded with added restrictions, dangerously moving away from the basic objectives we seek.

Progress in the work of the Committee of Twenty has been too slow and should move with a greater sense of urgency. The time has come to give renewed impetus to our efforts in behalf of a stronger international economic order.

To that end, in consultation with our trading partners and in keeping with the basic principles of our proposals for monetary reform, we are taking a series of actions designed to achieve three interrelated purposes:

(a) to speed improvement of our trade and payments position in a manner that will support our effort to achieve constructive reform of the monetary system;

(b) to lay the legislative groundwork for broad and outward-looking trade negotiations, paralleling our efforts to strengthen the monetary system; and

(c) to assure that American workers and American businessmen are treated equitably in our trading relationships.

For these purposes:

First, the President is requesting that the Congress authorize a further realignment of exchange rates. This objective will be sought by a formal 10 percent reduction in the par value of the dollar from 0.92106 SDR to the dollar to 0.82895 SDR to the dollar.

Although this action will, under the existing Articles of Agreement of the International Monetary Fund, result in a change in the official relationship of the dollar to gold, I should like to stress that this technical change has no practical significance. The market price of gold in recent years has diverged widely from the official price, and under these conditions gold has not been transferred to any significant degree among international monetary authorities. We remain strongly of the opinion that orderly arrangements must be negotiated to facilitate the continuing reduction of the role of gold in international monetary affairs.

Consultations with our leading trading partners in Europe assure me that the proposed change in the par value of the dollar is acceptable to them, and will therefore be effective immediately in exchange rates for the dollar in international markets. The dollar will decline in value by about 10 percent in terms of those currencies for which there is an effective par value, for example the Deutsche mark and the French franc.

Japanese authorities have indicated that the yen will be permitted to float. Our firm expectation is that the yen will float into a relationship vis-a-vis other currencies consistent with achieving a balance of payments equilibrium not dependent upon significant government intervention.

These changes are intended to supplement and work in the same direction as the changes accomplished in the Smithsonian Agreement of December 1971. They take into account recent developments and are designed to speed improvement in our trade and payments position. In particular, they are designed, together with appropriate trade liberalization, to correct the major payments imbalance between Japan and the United States which has persisted in the past year.

Other countries may also propose changes in their par values or central rates to the International Monetary Fund. We will support all changes that seem warranted on the basis of current and prospective payments imbalances, but plan to vote against any changes that are inappropriate.

We have learned that time must pass before new exchange relationships modify established patterns of trade and capital flows. However, there can be no doubt we have achieved a major improvement in the competitive position of American workers and American business.

The new exchange rates being established at this time represent a reasonable estimate of the relationships which—taken together with appropriate measures for the removal of existing trade and investment restraints—will in time move international economic relationships into sustainable equilibrium. We have, however, undertaken no obligations for the U.S. Government to intervene in foreign exchange markets.

Second, the President has decided to send shortly to the Congress proposals for comprehensive trade legislation. Prior to submitting that legislation, intensive consultations will be held with Members of Congress, labor, agriculture, and business to assure that the legislation reflects our needs as fully as possible.

This legislation, among other things, should furnish the tools we need to:

(i) provide for lowering tariff and non-tariff barriers to trade, assuming our trading partners are willing to participate fully with us in that process;

(ii) provide for raising tariffs when such action would contribute to arrangements assuring that American exports have fair access to foreign markets;

(iii) provide safeguards against the disruption of particular markets and production from rapid changes in foreign trade; and

(iv) protect our external position from large and persistent deficits.

In preparing this legislation, the President is particularly concerned that, however efficient our workers and businesses, and however exchange rates might be altered, American producers be treated fairly and that they have equitable access to foreign markets. Too often, we have been shut out by a web of administrative barriers and controls. Moreover, the rules governing trading relationships have, in many instances, become obsolete and, like our international monetary rules, need extensive reform.

We cannot be faced with insuperable barriers to our exports and yet simultaneously be expected to end our deficit.

At the same time, we must recognize that in some areas the United States, too, can be cited for its barriers to trade. The best way to deal with these barriers on both sides is to remove them. We shall bargain hard to that end. I am convinced the American workers and the American consumer will be the beneficiaries.

In proposing this legislation, the President recognizes that the choice we face will not lie between greater freedom and the status quo. Our trade position must be improved. If we cannot accomplish that objective in a framework of freer and fairer trade, the pressures to retreat inward will be intense.

We must avoid that risk, for it is the road to international recrimination, isolation, and autarky.

Third, in coordination with the Secretary of Commerce, we shall phase out the Interest Equalization Tax and the controls of the Office of Foreign Direct Investment. Both controls will be terminated at the latest by December 31, 1974.

I am advised that the Federal Reserve Board will consider comparable steps for their Voluntary Foreign Credit Restraint Program.

The phasing out of these restraints is appropriate in view of the improvement which will be brought to our underlying payments position by the cumulative effect of the exchange rate changes, by continued success in curbing inflationary tendencies, and by the attractiveness of the U.S. economy for investors from abroad. The termination of the restraints on capital flows is appropriate in the light of our broad objective of reducing governmental controls on private transactions.

The measures I have announced today—the realignment of currency values, the proposed new trade legislation, and the termination of U.S. controls on capital movements—will serve to move our economy and the world economy closer to conditions of international equilibrium in a context of competitive freedom. They will accelerate the pace of successful monetary and trade reform.

They are not intended to, and cannot, substitute for effective management of our domestic economy. The discipline of budgetary and monetary restraint and effective wage-price stabilization must and will be pursued with full vigor. We have proposed a budget which will avoid a revival of inflationary pressure in the United States. We again call upon the Congress, because of our international financial requirement as well as for the sake of economic stability at home, to assist in keeping Federal expenditures within the limits of the President's budget. We are continuing a strong system of price and wage controls. Recent international economic developments reemphasize the need to administer these controls in a way that will further reduce the rate of inflation. We are determined to do that.

The cooperation of our principal trading and financial partners in developing a joint solution to the acute difficulties of the last few days has been heartening. We now call upon them to join with us in moving more rapidly to a more efficient international monetary system and to a more equitable and freer world trading system so that we can make adjustments in the future without crises and so that all of our people can enjoy the maximum benefits of exchange among us.