DEPOSITORY

FOREIGN TRADE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-SECOND CONGRESS

FIRST SESSION

ON

WORLD TRADE AND INVESTMENT ISSUES

MAY 17, 18, 19, 20, AND 21, 1971

Part 2 of 2 Parts

(Appendixes)

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Appendix A

Communications Received by the Subcommittee on International Trade Expressing an Interest in the Subject of Foreign Trade

U. S. EMPLOYMENT AND FOREIGN TRADE

STATEMENT BY GEORGE H. HILDEBRAND
DEPUTY UNDER SECRETARY FOR INTERNATIONAL AFFAIRS,
U. S. DEPARTMENT OF LABOR
TO THE SENATE FINANCE COMMITTEE,
SUBCOMMITTEE ON INTERNATIONAL TRADE
JUNE 14, 1971

I. Introduction

Recent changes in the world economic structure pose new problems for U. S. international economic relationships. Significant changes include the internationlization of production by the multinational corporation, the startlingly rapid economic growth of Japan, the increased economic power of the European Economic Community, and the Green Revolution in less-developed countries. All of these changes affect the U. S. competitive trade position, and accordingly, U. S. income and employment.

This relationship between trade and jobs is a fundamental basis for Department of Labor involvement in the formulation of U. S. trade policy. The Department of Labor is part of the Interagency Trade Organization which deals with trade policy, tariff negotiations, escape clause actions, adjustment assistance, fair labor standards, etc. It has the primary responsibility of assuring that U. S. foreign economic policy takes full account of U. S. employment and manpower programs, and, specifically the impact of U. S. foreign trade and investment on jobs, income, and the standard of living of

American workers. At the same time, the impact of foreign economic policy upon domestic employment should be viewed against the broad sweep of changes in the domestic economy. Examination of the influence of foreign trade on employment and on workers' incomes must consider the basic economic conditions of the period under analysis.

II. Economic Background

A. The Implications of U. S. Domestic Changes

The United States has contributed to the growth of the international economy of the Free World over the past quarter century in two conspicuous ways. First, it contributed leadership and resources, in the aftermath of World War II, to the reconstruction of war-torn economies, the development of international trade and investment and an economic environment of increasing openness. Second, the U. S. contributed by maintaining a generally high level of domestic activity, which yielded a growth of productive capacity that was the source of exports on a huge scale, and that allowed the development of a relatively open domestic market that was both an attraction and a challenge to foreign suppliers.

During the period 1950-1969, real output in the U. S. more than doubled; the annual rate of change in the 60's was even faster than in the 50's--from 1961 to 1969, it was in excess of 5 percent. From 1958--the end of the post-war reconstruction and the beginning of active international competition--to the present the growth of the annual real output of the U. S. economy amounts to $280 billion expressed in 1958 dollars. This enormous increase in U. S. output over a period of 12 years is more than twice the present level of annual real output of West Germany.

The achievement of this growth has been made possible by a great expansion of the labor force and of the numbers of those employed, and at the same time by a substantial increase in the efficiency of labor, capital, and management.

In 1958, the civilian labor force was 67.6 million; in 1970 it was 82.7 million, an increase of 15.1 million or 22 percent. The increase in civilian employment was even greater--15.6 million--and, since farm employment continued its long down-trend, the increase in non-agricultural employment from 1958 to 1970 was 17.7 million, or 31 percent.

Data for non-agricultural establishments indicate that there was an even faster rate of growth of payroll employment in that

interval; between 1958 and 1970 it grew by 38 percent, from 51.4 million to 70.7 million. The salient feature, however, was that the growth in manufacturing payroll employment was a little less than 22 percent (and for all goods-producing industries it was just 20 percent), whereas service-producing industries showed an increase of over 48 percent. By 1970, there were twice as many people on service-producing industry payrolls as on goods-producing industry payrolls. Since the real product of those two industrial groups increased at about the same rate, it is possible to characterize this development as a shift of labor towards the service-producing industries.

In money terms, personal consumption expenditures on services in 1970 exceeded expenditures on nondurable consumer goods for the first time ever and accounted for over 42 percent of total personal consumption expenditures, as compared with only one-third in the immediate aftermath of World War II. The movement is not surprising--it reflects not only the increased demand for services as material wants are satisfied but also of the above-average increases of the prices of services in which labor productivity may be hard to raise but where wage rates tend to follow the general upward trend.

It is in the nature of mature economic development that later productivity gains are harder won than earlier gains, since initial gains are in some measure derived from economies of scale. Nevertheless, the U. S. postwar record has been highly creditable, averaging an annual increase of 3.1 percent in output per man-hour in the private economy over the 20 years ending in 1969. The slower productivity gains of 1967, 1969 and early 1970 may be symptoms of cyclical sensitivity rather than changes in the long-run trend--a view that finds support in the resumption of high productivity growth in the second quarter of 1970. As activity picks up in 1971-72, we may expect to have a continuation of productivity growth rates above the trend rate of 3.1 percent, with increasing utilization of capacity and the resultant improved efficiency of labor.

The achievement of industrial maturity by many other countries has enabled them to record productivity gains far in excess of U. S. gains. In some cases, this result arises from the very low output base from which they began a quarter century ago, and the attendant benefits from new technology and increasing scale of output. With much lower earnings levels, these countries have in recent years been able to increase their payments for labor and yet to record only small rises, or even a few declines, in labor costs per unit

of output. By contrast, the United States in the 1965-69 period has had an annual average increase in unit labor costs of 3.6 percent, which is higher than that of all the other major industrial countries except Canada. Yet in that same period, the annual average 5.8 percent rise of compensation per man-hour in the United States was lower than in any of these countries, with the exception of Italy.

It appears, then, that a critical question for the U.S. is whether it can maintain its international competitiveness by at least matching the performance of other countries in limiting the rise of labor costs per unit without asking labor to bear the cost of this action. This calls for a lower rate of increase of prices in general in the United States than elsewhere; and it is worth remembering that until 1965 this was the general rule. To take consumer prices, it was only in 1966 that the rate of price increase moved above 3 percent per annum on a sustained basis, and it appears that the peak rate of 6.1 percent was reached in 1969 and early 1970. Since that time we have moved back to the range of 4-4-1/2 percent. Experience suggests that other countries will have difficulty in matching this performance over any long period.

The U.S. ability to control price increases will depend not only on the actions of business and labor, but also on Federal, State, and local policies. For example, new standards on

environmental protection which are not imposed on foreign producers may weaken the competitive position of U. S. producers vis-a-vis both imports and exports. Similarly, diversion of resources to defense needs, or policies which place a premium on transfer of production to overseas plants adversely affect the competitive capability of domestic U. S. firms.

II. B. Changes in Trade Patterns

As the foreign trade of the U. S. grows and changes, employment in domestic industries is affected in a number of ways. Just as exports comprise a significant part of total demand for many domestic industries, export-related jobs are an important part of the labor force in these industries. Some jobs in other industries which supply the exporting industries are also export-related. The Bureau of Labor Statistics has estimated that the number of jobs involved in producing the goods that were actually shipped out of the country rose from 2.5 million in 1965 to 2.7 million in 1969, an increase of about 12 percent. In all, the jobs related to merchandise exports represented 3.8 percent of the private labor force in 1969.

Imports that compete directly with domestic products may limit job opportunities in the industries producing those products. However, imports of items not produced in the United States, or produced

in insufficient quantities, are entirely consistent with expanding job opportunities in consuming industries. It is extremely difficult to determine the employment effect of imports, but the Bureau of Labor Statistics has estimated that in 1969 it would have required about 2.5 million domestic jobs to produce the value of competitive imports; this reflects an increase of nearly 64 percent over 1965.

The 2.5 million is neither the number of jobs lost to U.S. imports nor the number of new jobs which would be created if we did not import. It is the best available estimate of the number of man-years which would have been required in 1969 to produce the value of replaceable imports in that year. It assumes that both the physical and human resources would have been simultaneously available to produce these goods, that any decline in imports would not have affected exports and export-related employment, and that there would have been no effect on U.S. price levels.

There has been a significant change in the pattern of U.S. trade over the past 10 or 15 years. In the years 1956-1960, our imports divided about evenly between crude materials and food on the one hand, and semi-manufactures and finished goods on the other hand. Now the balance has swung heavily in favor of finished goods. Imports of finished manufactures have risen from less than one-third

to well over half of our trade. The concentration of finished goods in exports has also increased (largely in the form of high-technology items like computers and aircraft), but not as rapidly as the increase in imports of finished goods.

Labor intensity involves both the amount of work required to produce a given product compared with other products and the skills of the workers. (Normally, wage levels are used as a measure of skill levels). The entire question of labor intensity is one in which little work has been done and where most statements are based either on greatly outdated studies or on limited observations. With these qualifications in mind, it is noted that recent import increases have been concentrated in a few industries such as footwear, electronics assembly, and certain other consumer goods. These are relatively low-wage industries which are clearly labor intensive in terms of skill levels and are probably labor intensive in terms of manhours. Thus, the problems of adjustment are intensified. The simultaneous shift towards a service-oriented economy amplifies the problem.

There has also been a significant change in the composition of import sourcing. In 1962, imports from the Far East (Japan, Hong Kong, Taiwan, Korea and the Singapore area) were $1.8 billion and accounted for less than 11 percent of our total imports.

In 1970, imports from these countries had jumped to $8.1 billion, over 20 percent of our trade. The switch to the Far East as a source is particularly significant in that labor costs in that area in most cases are significantly lower not only than those in the U. S. but those in European countries, intensifying the competitive pressure of imports.

III. Foreign Trade Theory

Since the time of Adam Smith, most economists have tended to support a liberal trade policy. This prescription is largely based on the theory of comparative advantage which says that freedom of goods to move around the globe will lead to the most efficient use of world resources. For each nation the prescription is the same:--if you want to export, then freely admit imports. If you do, in the long run you will concentrate your resources on what you can make more efficiently, buying from others what they can make more efficiently. In this way, workers will earn the highest possible real wages, capital will earn its optimum return, and consumption possibilities will be maximized.

Unfortunately, the comparative advantage model requires a number of rigid assumptions, many of which are unrealistic in the second half of the twentieth century. It is a static model, assuming no change in consumption patterns or the development of new products. It assumes that all the factors within a country--capital, labor and

natural resources--are perfectly mobile and fully employed and that adjustment takes place instantly. The model also requires perfect competition and the absence of barriers to trade.

The problem with comparative advantage theory has been clearly stated by Paul Samuelson in his 1970 Principles textbook:

> "Perhaps a more serious defect of comparative advantage is the static assumptions. The theory is stated in terms of barter and relative price ratios. It disregards all stickiness of prices and wages, all transitional inflationary and over-valuation gaps, and all balance of payment problems. It pretends that when workers go out of one industry, they always go into another more efficient industry--never into chronic unemployment. To the extend that we can in the future count on the successful macroeconomic management, which mobilizes modern theories of monetary and fiscal policy to banish chronic slumps and inflations--to that extent will the old classical theory of comparative advantage retain its vital social relevances."

Perhaps the most serious challenge to comparative advantage theory has been the recent rise of the multinational corporation (MNC). Multinational corporations respond to a diversity of motives, many of which are non-market in nature. Direct foreign investment is influenced by such factors as differences in tax laws, trade barriers, antitrust policy, and political conditions. The size of many MNC's indicates they have substantial market power, and will behave more like oligopolists than like perfect competitors.

These corporations enable a speedy transfer of capital, technology, and managerial experience among countries. To the extent that this transfer involves moving labor-intensive operations to countries with particularly low labor costs, the size and rate of growth of direct foreign investment will have a substantial impact on employment and job opportunities both in the U. S. and abroad. We can obtain some idea of the relative magnitudes involved by noting that in 1966 U. S. overseas production was estimated at $110 billion, compared to exports of goods and services of $43 billion, or 2-1/2 times as much. The book value of U. S. investment overseas rose from approximately $29 billion at the beginning of 1960, to approximately $71 billion in the beginning of 1970.

At present there is a dearth of both theoretical and empirical knowledge concerning the net effect of the multinational corporation

on trade and investment patterns. These concerns may serve to increase the competitiveness of international trade, to hasten industrialization in the developing countries, to promote exports of production equipment and of components, and to strengthen the balance of payments of capital-equipment producing countries. Conversely, they may operate at the expense of social reponsibility, they may be solely motivated by profit maximization based on the availability of lower wages, and increasingly they may involve products destined for U.S. markets which had previously been produced domestically. Critics also assert that cross-border intra-company shipments are often artificially valued for company accounting purposes and seriously distort the interpretation of trade statistics.

The facts are that there are no firm data on the impact of the multinational corporation on U.S. trade and employment. There is need to develop accurate data on the movement of production to overseas sources; the effect of such movement on domestic employment and collective bargaining; the volume of both imports and exports which reflects intra-corporate transfers including transfers between non-subsidiary affiliates. Without such data, attempts to define, evaluate, or control actions of multinational corporations are bound to generate even greater problems.

IV. The Adjustment Mechanism for Workers

The goal of liberalization is obviously long-run. In its pursuit we cannot overlook the short-run consequences for some domestic import-competing industries and their workers. When imports increase rapidly and are concentrated in product sectors, economic dislocations do in fact occur. Where imports contribute to the displacement of workers, for example, our trade and manpower programs should provide the means for appropriate correctives. One of the central tasks of manpower policy is to cushion the shocks of both temporary and limited structural displacement by providing adequate means for adjustment. In this sense, adjustment policy and trade policy must go hand-in-hand.

Since as a general rule, the U. S. has benefited from increased trade, the use of restrictive trade measures is not desirable and should be considered only in extraordinary cases and as measures of last resort. To the extent that measures of domestic adjustment assistance coupled with external adjustments and improved international labor standards can meet the problem, we are ahead of the game, and in a position to move ahead in the direction of expanded reciprocal world trade.

With the Trade Expansion Act of 1962, the Congress broke new ground in establishing a program of adjustment assistance for particular firms or groups of workers injured or threatened with injury by competitive imports. However, between 1962 and 1969, it was all promise and no performance. But the log jam was broken by the Tariff Commission in November, 1969. Since that time some 40 worker cases have been processed and about 15,000 workers certified by the Department of Labor as eligible to apply for adjustment assistance. Another 20 to 30 worker cases are in varying stages of processing and about 10 cases involving firms are being handled by the Department of Commerce. The certifications issued by the Department of Labor include workers in 15 states and in industries ranging from steel fabrication through electronics assembly operations. The largest number of workers have been in the footwear industries, both leather and rubber soled; consumer electronics; and sheet glass.

Assistance now available to workers under the Trade Expansion Act of 1962 includes monetary payments to help tide them over between jobs; training to help prepare for alternative employment; job counseling and referral; and if necessary, and where the workers

are willing, relocation to places where jobs are available. The emphasis is on training and job placement rather than on income maintenance. The obstacles are formidable to speedy placement in a job at least as good as the one which he lost, but a concerted Federal-State effort is now showing signs of significant progress.

It would appear, however, on the basis of recent actual experience that the program could be improved. In this regard we are currently conducting an intensive study of the implications of a number of possible changes in the statutory authority underlying the present program.

V. International Fair Labor Standards

To some extent import competition reflects lower labor costs abroad. In turn, in some cases lower costs for labor may reflect undesirable working conditions or wages that are below normal for the industry or even the whole economy of the exporting country. Cost advantages of the latter types

tend to undermine labor conditions in the importing country, posing the question of whether international minimum labor standards should be sought, which would reduce the impact of low-wage import competition. To do this two basic steps would be required:

1. To obtain international agreement on the definition of fair labor standards--what are appropriate criteria for deciding when unreasonable differences in labor costs occur, given the vast disparities in real income among countries.
2. To establish an international mechanism to enforce these standards, at least with respect to goods moving in international trade.

Clearly, too, the height and the range of such standards can adversely affect job opportunities in lower wage export countries. This influence must be weighed against the setting of standards for job protection purposes in the importing countries.

In its report on the Proposed Trade Act of 1970 the Ways and Means Committee indicated that the President should take steps with respect to trade agreements which would lead to the elimination of unfair labor conditions which substantially disrupt international trade. They suggested that machinery be set up in such trade agreements to provide for 1) the international

recognition of basic principles with respect to earnings, hours, and conditions of employment; 2) the development of a complaint procedure (presumably in the GATT) under which situations of unfair labor conditions affecting international trade could be brought before the parties of the agreement for appropriate remedial action; and 3) the establishment of a system of periodic reports, by all parties to the agreement, on earnings, hours, and conditions of employment for workers in the exporting industries of the countries involved.

This is a possibly fruitful approach that has the special advantage of reflecting awareness of the need of the poorer countries for increased employment opportunities, in many cases, through exports. Ideally, such opportunities, however, would provide for an equitable sharing by those workers in the output of their labor. As the leader in world trade; the U.S. should take the initiative in encouraging serious study of the issue of international labor standards and the practical potentials of the device itself.

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In conclusion, the relationship between trade and employment must be examined against the background of a broad scope of events in both the domestic economy and the international economy.

Changes in trade patterns constitute only one source of economic dislocation, but because of their concentration and other unique characteristics, trade-generated dislocations offer opportunities for special treatment as well as a ready excuse to blame underlying problems on the outsider.

ASHLAND OIL, INC. • POST OFFICE BOX 391 • ASHLAND, KENTUCKY • 41101 • PHONE (606) 324-1111

ORIN E. ATKINS
President and Chief Executive Officer

May 21, 1971

Senator Abraham A. Ribicoff
321 Old Senate Office Building
Washington, D. C. 20510

Re: U. S. Balance of Payments Situation

Dear Senator Ribicoff:

In view of the hearings which you have conducted on world trade and investment issues on May 17-21, I believe you will be interested in the study carried out for Ashland Oil by Mr. Alan Greenspan, President of Townsend-Greenspan & Co., Inc., which deals with the effects of investment controls on U. S. operations overseas. Recent action of the German Government and other governments which reflect their uncertainty as to the value of the dollar have clouded the basic issues. However, in the not too distant future we see the present investment control system as a threat to American investments abroad. We believe that controls on capital movements should be removed at the earliest practicable date.

Cordially yours,

Orin E. Atkins

OEA:mw
Attachment

THE U.S. FOREIGN DIRECT INVESTMENT PROGRAM: A THREAT TO THE AMERICAN DOLLAR

A Study of the Financing Problems Confronting U.S. Foreign Affiliates

For: Ashland Oil Co., Inc.
By: Alan Greenspan, President
Townsend-Greenspan & Co., Inc.
January, 1971

Summary and Conclusions

1. The mandatory foreign direct investment program after three years of operation is finally beginning to threaten the competitive viability of U.S. foreign affiliates.

2. To date, although under pressure to redirect their financing requirements to foreign sources, affiliates' asset expansion has continued unabated. Rapidly rising debt/equity ratios, however, indicate that further expansion, under existing regulations, is going to become progressively more difficult.

3. Inevitably, the earnings capability and growth of these affiliates will be restricted and their market values as going concerns impaired.

4. Since these assets serve as the major standby reserve supporting the U.S. dollar as the key world reserve currency, the direct foreign investment control program is threatening the status of the dollar. This is directly counter to the stated objective of the program.

5. If a major purpose of our foreign economic policy is to preserve and reinforce the U.S. dollar in its key reserve currency status, a rapid unwinding of the foreign direct investment control program is mandatory.

Financing Difficulties

Under the existing direct investment control mechanism, foreign affiliates of U.S. corporations are going to encounter severe difficulties financing the capital expenditures planned for 1971. Plant and equipment outlays by affiliates, excluding those domiciled in Canada[1], were scheduled at $9.7 billion for 1970, up 16% from 1969, according to the most recent survey taken in June 1970.[2] Expenditures planned for 1971 were $11.7 billion, up 21% from last year's level. Unless plans were cut back late in the year, we estimate that affiliates had to raise approximately $8.2 billion of external funds to finance last year's investments. Approximately $5.5 billion was in the form of debt, both long and short-term, raised in foreign money markets. A modest amount (a few hundred million dollars) represented issuance of equity securities abroad. The remainder came from U.S. direct investment sources, almost all from the U.S. parent corporations. Last year's foreign financing requirements were more than triple those of 1967.

Even with markedly higher internal fund generation and eased limits on parent financing, foreign affiliates will have to borrow nearly $7 billion abroad in 1971 to meet their capital expenditure projections.

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1 Throughout this paper affiliates will refer only to non-Canadian direct investments, i.e., those subject to controls under the Office of Foreign Direct Investment.

2 See Survey of Current Business, September, 1970, p. 22. The data in Table 1 differ slightly, owing to an alternate method of calculation.

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Total external financing, excluding U.S. net capital outflow, would reach $7.9 billion.[3] (Table 1) Should such financing actually materialize, it would amount to 2.6 times the estimated net receipts of funds from parents and other U.S. direct investment sources. This compares with an estimated 2.5 times in 1970 and a range of .9 to 1.7 from 1958 through 1967, the ten years immediately prior to the imposition of mandatory direct investment controls. It would also mean that, by the end of 1971, 48.3% of affiliate assets would be financed by other than U.S. direct investment sources, a sharp rise from last year's 46.8% and the 43.6% at the end of 1967. (Table 3) Although no data are available directly, our numbers also imply marked increases in debt/equity ratios in recent years.

However, these shifts in the sources of financing of foreign affiliates do not take into account the pronounced increase in the proportion of the parent companies' investment in affiliates obtained through funds raised abroad. U.S. domiciled companies' flotations in the Eurobond and international bond markets have risen dramatically. Of the $4.0 billion raised abroad during 1968-1970 by U.S. corporations, approximately $1.8 billion was reported to have been directly invested in foreign affiliates (27% of the reported net U.S. capital outflow to such affiliates). In addition, other borrowing abroad by U.S. corporations increased sharply since there are no restrictions on the investment of such funds to finance affiliates.

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3 This includes some funds from the U.S., borrowing from other affiliates and minority retained earnings. See Appendix for inclusions.

Thus, if we consolidate[4] the financial operations of U.S. corporations abroad, we find that of all the foreign assets owned directly and indirectly (through affiliates) by U.S. corporations, 46.3% were financed by other than U.S. funds at the end of 1967 and an estimated 55.1% at the end of 1970.[5]

In the near-term the recent sharp reduction in Eurodollar borrowings by U.S. commercial banks and the eased money market conditions abroad are likely to facilitate U.S. parent and affiliate foreign borrowings. It is questionable, however, whether amounts approximating $7 billion can be raised abroad this year, even in a relatively accommodating climate.

The rapidly rising debt/equity ratios have already restricted borrowings of some companies. A recent survey by the U.S. Council of the International Chamber of Commerce indicated a "growing apprehension about being able to find alternative financing to meet investment schedules if the control program continues."[6] This concern is reinforced by uneasiness on the part of some European officials that U.S. companies are far too deeply in debt. Moreover, they are cracking

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[4] The consolidation is for statistical comparisons only. Some U.S. domiciled corporations have foreign assets and liabilites resulting from commercial transactions only. The consolidation also masks important industrial and regional trends.

[5] See Table 5.

[6] The Impact of U.S. Controls on Direct Investment -- A Survey of Company Experience With The Foreign Direct Investment Program, (United States Council of the International Chamber of Commerce, Inc., New York, 1970), summary.

down when they think debt is too high.[7] There is no evidence, however, that any wholesale curtailment of overseas investments has as yet taken place.

However, even should foreign affiliates, with the assistance of their parent corporations, somehow manage to raise abroad the external funds required to meet the capital investment schedules for 1971, the trend in financing of affiliates would still be in fundamental disequilibrium. The rapidly rising trend in debt-equity ratios simply cannot be extended much further. Although some equity offerings to foreign investors undoubtedly will occur in the near future, the basic financing problem is not likely to change.

Our statistical analysis confirms the conclusions in the International Chamber of Commerce survey that "continuation of the program will soon adversely affect the level of finance; that is, the extent of the investment support which is crucial in maintaining the competitive position of American business abroad and the effective use of American technology and managerial grasp."[8]

Should deterioration in the competitive position of U.S. affiliates begin to occur, it is unlikely to show up immediately in any measurable increase in our balance of payments deficit. In fact, the immediate effect could conceivably be an improvement in our balance of payments if

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[7] Business Week, December 19, 1970, p. 102

[8] Impact of U.S. Controls, op. cit, summary.

discouraged U.S. corporate managers decide to liquidate investments abroad and repatriate the capital. More important to the status of the dollar as the world's key reserve currency is the fact that the market value of U.S. foreign affiliates would inevitably undergo a severe downward adjustment as rapidly growing income flows[9] slowed, causing implicit price/earnings ratios to fall.

The viability of the U.S. dollar as the key reserve currency depends, not on short-term international flows, but on the structure of our international assets. The U.S. foreign direct investment position, excluding Canada (approximately $54 billion), is by far the most important backup reserve to the U.S. dollar in world transactions.

While for balance of payment bookkeeping purposes we count our direct investments as long-term assets, much of this huge stock of capital is, in fact, quasi-liquid. Many foreign affiliates could be sold wholly, or in part, for foreign currencies. In a broad sense, they are only moderately less marketable than equity in domestic U.S. corporations.

The worst investment the United States can make is to trade some modest, and questionable, improvement[10] in a statistical proxy (our conventional balance of payments deficit measures) for a deterioration in the market value of our foreign assets.

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[9] See Table 9.

[10] See p. 15, below.

The Case for a Balance of Payments Program

The mandatory direct foreign investment program is merely an extension of earlier efforts to hold down our conventionally measured balance of payments deficit[11] and prevent a deterioration of the dollar as a reserve currency.

The conventional view has maintained that if the expansion of U.S. short-term foreign liabilities continued beyond the point at which foreigners were willing to absorb the flow, then the foreigners would exchange the dollar claims at their own central banks for their local currencies. Since the foreign central banks would not be likely to acquiesce in an indefinitely expanding hoard of U.S. dollars, they would begin turning them in, in quantity, for our relatively meager gold stocks. At the point where the U.S. gold stocks were depleted or where the U.S. Treasury was no longer willing to exchange our remaining gold for U.S. dollars, the whole structure of fixed exchange rates would break down. To avoid this sequence of events, "temporary" controls are needed to slow the expansion of U.S. dollar liabilities.

While differing in form, all justifications for direct investment control programs require the belief that an activist balance of payments policy is essential if the U.S. dollar is to remain the kingpin in the world fixed exchange rate system.

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11 Direct investment controls were first introduced on a "voluntary" basis in February 1965 in line with a long series of actions, dating back to 1959, designed to improve the United States balance of payments position. For a detailed listing of the major measures see The Cost of World Leadership (American Bankers Association, New York, 1968), pp. 23-25.

Some Problems

Certainly, much can be said for the concern over foreign economic policy implicit in such justifications. But are controls over direct investment helpful or counterproductive? It is often argued that foreigners have no choice but to finance our deficits. To cease to be willing to hold dollars, it is averred, would plunge the international monetary system into disarray, to the detriment of all major financial powers-- particularly those who are the major dollar holders. Thus, it is to the self-interest of West Germany, Japan, Switzerland, et. al., to support the dollar.

Doubtless in the short-run, the willingness of foreign central banks to accumulate dollar denominated liquid assets is affected by political considerations. Concern over threats to the existing international financial structure can have a major influence upon the quantity of dollars central banks would be willing to absorb. Foreigners have been, and apparently are still, willing to subsidize the United States to a certain degree. But it is a subsidy. If the dollars are overvalued (i.e., claims with a presumed real asset liquidation value of, say, 90¢ on the dollar), then at least part of any "involuntary" absorption of dollars is an exchange of real assets for overvalued claims.

In the longer-run, however, it is the underlying supply and demand for dollars based on real asset purchasing power equivalents which will govern the holdings of such central banks. It is scarcely likely that foreigners will continue to absorb dollars when, in effect, their real value is eroding.

A well-calibrated revaluation by a reluctant holder of U.S. dollars would have the immediate effect of redressing the imbalance and shutting off the flow of new dollars, but at the expense of writing down the value of already existing holdings of dollar assets in terms of the home currency. Such revaluation would also place the revaluing country at a competitive trade disadvantage vis-á-vis other countries.[12] Dollar reserve markdowns are likely to occur perhaps once or twice, but recognition of a chronic[13] overvaluing of the dollar must finally lead to attempted liquidation of dollar holdings. This certainly would hasten the emergence of a common currency in Europe and a major shift out of U.S. dollars as a reserve currency. Moreover, it would have staggering consequences for U.S. foreign, if not domestic, economic policy. Thus, the belief that the major financial powers cannot afford to allow the dollar to be undermined as the international reserve currency is an illusion.

If foreign central monetary authorities finally begin to stop supporting the U.S. dollar, what type of mechanism can we expect to generate foreign exchange values? As a last resort, the U.S.

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[12] Of course, if a group of countries, e.g., the Common Market members, all concurrently revalue by the same proportion against the dollar, competitive disadvantages would diminish.

[13] If the revaluation permanently (or over a protracted period) restores equilibrium, then no further problem exists. However, if the cause of the imbalance, e.g., inflationary U.S. domestic policies, continues to erode the dollar relative to the foreign currency, a new imbalance will emerge requiring further revaluation.

dollar might be allowed to "float" and seek its own level relative to other currencies. Alternatively, U.S. monetary authorities could attempt to support a new set of exchange parities by buying and selling dollars for other currencies.

There would, of course be no difficulty in obtaining dollars to sell -- they would merely be "printed." The problem would lie in obtaining foreign currencies or their equivalent, gold and SDR's, with which to buy dollars. U.S. reserve assets of $15 billion may seem large, but they would rapidly disappear if the United States attempted to support the dollar at too high a value. In fact, any indication of a further decline in our basic reserve assets could accelerate the sale of dollars by foreigners.

Where are the secondary reserves to support the dollar in the foreign exchange markets? We rule out further borrowings of foreign currencies via swaps from foreign central banks since by our hypothesis they would no longer be willing to support the dollar (a swap is merely another way of accumulating additional dollars).

The penultimate fallback is the very substantial portfolio of foreign currency denominated securities held by Americans ($10 billion), as well as the U.S. direct investments abroad which can be valued directly in their domiciled currencies.[14] Direct investment enterprises are readily convertible into foreign currencies either by sale of equity shares or by outright sale or liquidation of whole affiliates.

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[14] The ultimate support, of course, is the vast real wealth of the United States: domestic assets denominated in dollars, but saleable for foreign currencies.

This substantial block of U.S. owned foreign currency denominated assets is the major secondary support underlying the demand for the U.S. dollar in foreign exchange markets.

To undermine the value of these highly marketable secondary reserves in order to obtain some small and questionable improvement in our primary reserve position (i.e., gold, SDR's, convertible currencies) is a very dubious transaction, to say the least.

And so we come full circle. Granting the basic purpose of a capital outflow control program, when tracked to its final conclusion, it becomes self-defeating. If the purpose of the U.S. foreign direct investment program is to preserve the status of the dollar as the critical reserve currency, our policies must be considered to be short-sighted at best.

The Source of Our Difficulties

In Tables 6 through 9 we have rearranged the balance of payments accounts in an attempt to segregate the items directly associated with the United States government receipts and expenditures and, as a residual, those items associated with the private sector.[15] Even before the Vietnam buildup, there was a persistent outflow on government account only partly offset by modest surpluses on private account (Tables 6 and 7). A large part, if not all, of the buildup in the government account deficit between 1965 and 1969 reflects the escalation

[15] See Appendix for details.

in our military expenditures owing to the Southeast Asian war (Table 8). However, with military expenditures showing little change in 1970, the basic government deficit has now widened substantially further.

Although there are a number of analytical questions which may be raised regarding this form of balance of payments analysis, it is difficult not to conclude that our problem is essentially a unilateral outflow on government account. Unless, and until, major improvement is made in this area, the belief that we can restore a basic balance in our international position is wishful thinking. If one accepts the conventional view of our balance of payments problems, there are no shortcut solutions -- the U.S. government's foreign outlays must be reduced.

There is, however, a large and growing body of views which largely dismisses concern over the U.S. balance of payments deficit and threats to the status of the dollar. Although these positions differ in many respects, they all essentially conclude that the United States official balance of payments policy should be passive; that U.S. controls on direct foreign investment outflow are neither necessary nor relevant.[16] Hence, justification for O.F.D.I. controls can not be found in either the conventional arguments or the newer conceptual frameworks governing balance of payment policies.

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[16] One group, with Prof. Milton Friedman as its leading proponent, argues that the U.S. dollar (and other currencies) should not be supported either by a tie to gold or by official intervention in the foreign exchange markets. They believe that if the dollar were allowed to "float" it would seek its own relationship with other currencies, facilitating the free flow of goods and capital.

There is a second and growing view among international financial economists which holds that the United States has become the central bank for the world and for that reason need not be concerned with its balance of payments deficits. They believe the United States should maintain a "passive position"

The Permanence of the Temporary

When originally promulgated in January 1968, it was maintained that the program, then instituted and now in force, would save $1 billion annually in foreign exchange. It was believed that once domestic inflationary pressures were brought under control, the United States' historically large trade surplus would re-emerge and a basic international financial balance could be restored. But since this process would take time, it was argued, an interim "protection" of our foreign exchange reserves was necessary.

One must now seriously question the length of the "interim" period of adjustment. The cynicism of the expression that there is "nothing so permanent as a temporary control" is not without historical precedent. The durability of the controls on direct investment depends not only on economic criteria but on bureaucratic considerations as well.[17] Moreover, the expectation of the occurrence of the type of international economic improvements required for direct investment controls to be gradually phased out seems to be based more on hope than analytical conviction. Numerous past forecasts, official and otherwise, of imminent improvement in our balance of payments have veered far from the mark.

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16 (Cont'd)
with respect to its international financial accounts and require foreigners to make the adjustments. See, for example, "The Future of the Dollar," First National City Bank Letter, November 1970.

17 See pp. 16-18 below.

The reason is that the forces underlying our international financial balances are so subtle and difficult to measure that even sophisticated models have been unable to capture even the basic trends with reasonable accuracy.[18]

Obstacles to Decontrol

The attempt of U.S. multinational coporations to "adjust" to the existence of controls has inevitably led them to alternative, presumably less desirable sources of funds. There are now some who, while acknowledging that the initiation of direct investment controls was a mistake, are also opposed to decontrol. Having now been factored into the multinational corporate financing structure, an unwinding of the controls would produce major problems.

Implicit in the controls is the presumption that foreign borrowing by either parent or affiliate corporations does not generate offsetting sales of other U.S. assets from the portfolios of foreign financial institutions and others. It is presumed that these claims against U.S. companies are absorbed by newly created loanable funds, coming in large part from real savings.[19] Against the alternative of financing affiliates with U.S. funds, such borrowing would represent a dollar for dollar savings in U.S. foreign exchange.

The corollary to this argument is that, should O.F.D.I. controls

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[18] See, for example, W.S. Salant, et. al. The United States Balance of Payments in 1968 (The Brookings Institution, Washington, D.C., 1963).

[19] This would imply a marked shift in the proportion of real savings being funnelled into U.S. assets, a somewhat tenuous position.

be scrapped, U.S. companies would immediately refinance these foreign borrowings with a resultant huge drain on U.S. foreign exchange reserve .

Hence the underlying assumption of O.F.D.I. controls is that foreigners do not disgorge other U.S. assets when absorbing the new U.S. debt instruments; and conversely that they would not repurchase other U.S. assets if Americans repaid recent borrowings.

What is the evidence? At the initiation of capital controls, a clearcut balance of payments improvement occurred. Hence there could not have been an immediate, major sale of other U.S. financial assets. The impact of the Interest Equalization Tax is evident in the sharp improvement in 1965 and the impact of the mandatory direct investment controls, with its accompanying large increase in foreign borrowing, in a major improvement in 1968 (Table 9). Both were only temporary gains, however. A relapse in the balance on private account followed within a year in both cases. This suggests then that net sales from foreign portfolios were only delayed.

If this is the case, then, the problem of refinancing is unlikely to be a difficult one when direct investment controls are unwound. Whatever refinancing does occur would leave foreigners with cash instead of previously held claims against U.S. business. We must presume that at least part, if not a large part, would be reinvested in other U.S. financial assets. Moreover, a substantial part of affiliate and parent company liabilities are longer-term and therefore would not be refinanced for years.

The "Law" of Regulation

Much of what has been said here on controlling direct investment has been said before. Certainly, there are few government controls which have raised such a furor of opposition. Even those administering the Office of Direct Foreign Investment have publicly stated their opposition to this control system as a permanent vehicle and have urged that it be used only as a short-term expedient.

Yet the controls persist and show disturbing signs of permanence. How is this possible? Is there some law of governmental regulation which somehow supercedes even the best judgment of the people who are most knowledgeable in the area?

In a sense, the answer is yes. Aside from the technical difficulties of terminating capital controls, it is instructive to approach the problem from the viewpoint of the controllers -- those whose self-interest lies not so much with the total consequences to the economy as with their specific positions and/or their authority.[20]

Since an administrator does not initiate the controls, only their continued functioning in a mechanistic, i.e., administrative, way is his concern. He therefore adjusts regulations to make the control system appear to function as efficiently as possible, or at least institutes policy

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20 There are numerous low-ranking individuals whose jobs are inevitably eliminated in a decontrol process but these individuals rarely, if ever, can cause a meaningless system to be perpetuated. To be sure, they may buttress the arguments of those making the final decisions, but second and third-level administrators are not the problem.

directives towards that end. Major changes always run the risk of disrupting the system and failing to achieve their objective. But a major expansion in control coverage, if it works or appears to work, has a definite bureaucratic benefit to match the risk. However, an unwinding of controls that allows the system to adjust with no obvious adverse consequences is a success which grants little bureaucratic or political advantage to an administrator. It may even indicate that the controls were never really necessary and that the controller himself had been advocating an unnecessary bureaucracy.

Moreover, the benefits from eliminating any control system must be judged over the long-run since the adjustment process will create at least some temporary disequilibrium. But the administrator's political time frame is highly foreshortened. From his point of view, the possible political costs, including the personal risks involved in eliminating controls, may seem to outweigh even monumental long-term benefits to the economy as a whole. Consequently, the reluctance to end controls from an immediate short-term bureaucratic point of view is exceedingly strong. This, of course, is not a phenomenom which applies only to economic controls. It is a far broader problem which confronts any attempt to eliminate outmoded governmental programs.

Fine-Tuning the Controls

As the difficulties in financing the expansion of U.S. foreign affiliate assets emerge, as they inevitably must, the temptation will be

not to scrap the whole program, but to somehow adjust the degree of restrictions so as to facilitate the short-term capital requirements of our foreign affiliates. However, the belief that the deleterious competitive effects of the control programs can be prevented without the complete elimination of the control structure is naive.

There is no way to adjust the control system sufficiently quickly to meet the contemplated financing requirements of the affiliates. As with almost all types of regulation, the adjustment invariably occurs just a bit too late: after some, if not considerable, damage has been done. Moreover, exemptions would inevitably mean an increase in direct investment outflow, which is precisely what the control program was constructed to avoid.

To have a control mechanism, and not the presumed benefits, elevates the control apparatus itself as the goal of the whole exercise. There is no purpose in affording private corporations permission to implement decisions they would have made without the controls unless the control mechanism is a value, in and of itself, independent of any ends it seeks to achieve.

A Summing Up

We are led finally to the conclusion that in principle, and in practice, control over foreign direct investments will eventually undermine, rather than support, the U.S. dollar as the world's key reserve currency. The program is misdirected as to purpose. It is focusing

upon altering a statistical measure that is only a proxy for the underlying status of the dollar. It is allowing the means to obscure the end.

Attempts to modify the stringency of the regulations from year to year, as circumstances in foreign financial markets change, are misdirected. There is no alternative to a rapid dismantling of these counterproductive controls.

The longer the regulations are kept in place, the greater the cumulative damage to U.S. affiliates abroad. Delay in terminating tham is both unnecessary and costly.

TECHNICAL APPENDIX

A. U.S. Owned Foreign Affiliates: balance sheets and sources and uses of funds

Although there are no consistent official data on balance sheets or sources and uses of funds for U.S. foreign affiliates, sufficient information is available to construct useable estimates.

The last published census of U.S. owned foreign affiliates is for the year 1957.[1] A census, taken for the year 1966, is currently in the process of tabulation.

There are, however, selected industry (mining, petroleum, and manufacturing) and area data on sources and uses of funds for foreign affiliates for the years 1958 through 1965 and on a sample basis for 1967 and 1968.[2] In addition, consistent historical data are available on plant and equipment expenditures for all years, industries and areas. Complete net capital outflows are available quarterly from the official balance of payments accounts. Finally, U.S. shares in retained earnings are reported annually.

An all-industry sources and uses of funds set of estimates was constructed for the years 1958 through 1969 and tied to the 1957 asset

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[1] U.S. Business Investments in Foreign Countries, U.S. Department of Commerce, 1960.

[2] See Survey of Current Business, November, 1970, and earlier issues.

level base to generate corresponding balance sheets for all areas excluding Canada, i.e., the Office of Foreign Direct Investment "Scheduled Areas." Data on direct foreign investment and plant and equipment expenditures were the "base" elements on the sources and uses side respectively against which all other elements were estimated.

Ratios of the annual increases in receivables, inventories and other assets for the covered industries (mining, petroleum and manufacturing) to plant and equipment expenditures were calculated for the available years, with estimates assumed for 1966 and 1969. These were then applied to the plant and equipment expenditure data to complete the "uses" side.

Sources of funds for the covered industries include:

1. Net capital outflows as reported in the balance of payments accounts, less net acquisitions by U.S. companies of foreign enterprises in areas other than Canada. These include not only direct investments by U.S. parents in their affiliates but also sales of securities to U.S. residents and certain other nonparent investments which are defined as part of the direct investment account. No attempt was made to adjust for the small net capital flows between affiliates in Canada and elsewhere.

2. Reinvested earnings of affiliate corporations. By definition, undistributed earnings of foreign branches of U.S. corporations are assumed

to be repatriated and simultaneously reinvested. Hence, they appear as a net capital outflow.

3. Depreciation was estimated from ratios calculated to plant and equipment expenditures. No attempt was made to remove the small but unknown amount of depletion allowances from the sample published data. In terpolations were made for 1966 and 1969.

4. Net sales of fixed assets less associated deletions from depreciation accounts was estimated from the sample data "other sources and adjustments."

5. All other. Excluding statistical discrepancies the residual source of funds to finance the estimated uses would include (a) foreign minority interests in undistributed earnings of affiliate corporations, (b) borrowings from U.S. sources other than on direct investment account,[3] (c) issuance of equity securities to foreigners, (d) long and short-term borrowing from foreign financial institutions and others, and (e) funds from other affiliates. These last two items would also include a small amount of financing from Canadian sources. An estimated distribution of such residual funds for mining, petroleum and manufacturing (including

[3] This would include mainly short-term bank borrowings and open-book credit accounts.

Canada) for 1965 is as follows:

	Millions of dollars
Foreign minority interests in retained earnings	$ 206
U.S. financing, ex. direct investment	232
Issues of equity securities to foreigners	273
Borrowing from financial institutions	
Long-term	678
Short-term	653
Other increases in foreign liabilities	
Long-term	153
Short-term	1,596
Funds from foreign affiliates	225
Total	$4,016

Source: Survey of Current Business, January, 1967, pp. 29,31.

Sources and uses of funds for noncovered industries, i.e., transportation, utilities, trade, and other (which account for approximately a fifth of U.S. direct investment) had to be estimated indirectly. By definition, plant and equipment expenditures for these industries minus net capital outflow and reinvested earnings is equal to other sources of funds less other asset additions. The sources and uses tables were filled in on the basis of fragmentary data from the 1957 Census and the Office of Foreign Direct Investment's sample survey data of foreign affiliates for 1968.

Balance sheet

Two additional adjustments were required to create the changes in the

affiliate balance sheet. First, 44% of net acquisitions of foreign enterprises were distributed to net fixed assets and 56% to other assets. Secondly, valuation adjustments of the direct foreign investment account were applied entirely to net fixed assets. The U.S. foreign affiliate balance sheets were constructed by linking the changes for 1958-1969 to the end of 1957 levels shown in the last published Census. Attempts were made to compare the results with the O.F.D.I.'s sample survey of U.S. foreign affiliates. Our total estimated net fixed assets at the end of 1968, for example, are $35.7 billion compared with the estimated $28.4 billion obtained from the O.F.D.I.'s sample. Although it is difficult to make exact reconciliations because of definitional differences, it appears that the 1968 ratio of U.S. direct investment to total affiliate assets is slightly higher in the O.F.D.I. survey than in our estimated balance sheet.

Estimates, 1970: Projections, 1971

Plant and equipment expenditure estimates for 1970 and 1971 come from the Department of Commerce's semi-annual survey.[4] Other asset additions were assumed consistent with historical experience. Net capital outflow data are available for the first three quarters of 1970, the fourth quarter flow was assumed to be negative. Net capital outflow

[4] Survey of Current Business, September, 1970, pp. 21-25. See especially notes to Table 2.

for 1971 was assumed a fourth higher than 1970. Retained earnings were also projected up slightly for 1970 and 1971. "Other" claims were derived as a residual for both years.

B. U.S. Corporations: foreign balance sheet (excluding Canada)

These data represent the balance sheet of all U.S. corporations implicit in their transactions with the rest of the world, excluding Canada. (Table 4) The asset levels shown are consistent with the sources and uses shown in the official balance of payments table C2.[5] The data for the end of 1970 were obtained using nine months of reported sources and uses data and estimates for the fourth quarter of the year.

The balance sheet in Table 5 reflects the underlying assets and liabilities of the direct investment account (Table 3) as well as U.S. corporation direct assets and liabilities. (Table 4)

C. Balance of Payments Accounts

The segregation of U.S. international transactions to U.S. government and private accounts was based on official balance of payments tables 1, 5, A2, C1 and D1.[5] All receipts and payments clearly designated to U.S. government account were tabulated, with the private account being the residual.

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[5] See, for example, Survey of Current Business, December, 1970.

Although official data on special financial transactions are not available on the current definitional basis historically, we have attempted to reconstruct their major components and have cross-classified them between government and private account on the one hand and as they affect the official reserve and liquidity basis for the calculation of the U.S. international balance on the other.

Table 1

SOURCES AND USES OF FUNDS OF FOREIGN AFFILIATES OF U.S. FIRMS (Ex. Canada) (1)
Millions of Dollars

Sources of Funds

	Net Capital From U.S. (2)	Retained Earnings	Depreciation	Foreign and Other (1)	Net Sales of Assets	Total Sources
1958	640	656	1,207	904	82	3,490
1959	793	681	1,320	863	72	3,730
1960	973	877	1,465	905	75	4,296
1961	1,147	788	1,705	1,102	93	4,836
1962	1,140	827	1,835	1,209	79	5,091
1963	1,474	974	1,991	1,819	138	6,397
1964	1,708	925	2,432	2,335	164	7,565
1965	2,249	1,002	2,735	3,370	193	9,550
1966	2,000	1,192	3,085	3,447	157	9,882
1967	2,615	954	3,455	2,461	426	9,912
1968	2,139	1,403	3,928	4,060	272	11,803
1969	1,991	1,595	4,494	5,462	295	13,838
1970e	2,480	1,700	5,164	6,212	344	15,901
1971*	3,100	1,800	5,934	7,947	415	19,197

e = Estimate
* = Projection

(1) See Appendix A for description of terms.
(2) See Table 2.

Table 1 (Continued)

SOURCES AND USES OF FUNDS OF FOREIGN AFFILIATES OF U.S. FIRMS (Ex. Canada) (1)
Millions of Dollars

Uses of Funds

	Plant & Equipment Expenditures	Other Assets	Total Uses
1958	2,738	752	3,490
1959	2,427	1,303	3,730
1960	2,530	1,766	4,296
1961	3,106	1,730	4,836
1962	3,455	1,636	5,091
1963	3,789	2,608	6,397
1964	4,646	2,919	7,565
1965	5,593	3,957	9,550
1966	6,282	3,600	9,882
1967	7,034	2,878	9,912
1968	7,259	4,544	11,803
1969	8,451	5,387	13,838
1970e	9,830	6,071	15,901
1971*	11,860	7,337	19,197

e = Estimate
* = Projection

(1) See Appendix A for description of terms.
(2) See Table 2.

Table 2

U.S. FOREIGN DIRECT INVESTMENT ACCOUNT (Ex. Canada)
Millions of Dollars

	Book Value Beginning of Year	Capital Outflows: To Existing Affiliates	Capital Outflows: Net New Acquisitions	Retained Earnings	Valuation Adjustment	Book Value End of Year
1958	15,776	640	100	656	-50	17,122
1959	17,122	793	100	681	-73	18,623
1960	18,623	973	250	877	-37	20,686
1961	20,686	1,147	150	788	344	23,115
1962	23,115	1,140	200	827	-139	25,143
1963	25,143	1,474	137	974	-36	27,692
1964	27,692	1,708	322	925	-22	30,625
1965	30,625	2,249	257	1,002	23	34,156
1966	34,156	2,000	508	1,192	-74	37,782
1967	37,782	2,615	114	954	-76	41,389
1968	41,389	2,139	445	1,403	72	45,448
1969	45,448	1,991	460	1,595	194	49,688
1970e	49,688	2,480	400	1,700	0	54,268
1971*	54,268	3,100	400	1,800	0	59,568

e = Estimate
* = Projection

Table 3

BALANCE SHEET: U.S. FOREIGN AFFILIATES (Ex. Canada)
End of Year, Millions of Dollars

	Net Fixed Assets	Other Assets	Total Assets	U.S. Direct Investment	Other Claims	Total Claims	Other Claims/ Total
1957	12,677	16,619	29,296	15,776	13,520	29,296	.4614
1958	14,119	17,427	31,546	17,122	14,424	31,546	.4572
1959	15,125	18,785	33,911	18,623	15,288	33,911	.4508
1960	16,187	20,691	36,879	20,686	16,193	36,879	.4390
1961	17,904	22,505	40,410	23,115	17,295	40,410	.4280
1962	19,394	24,253	43,648	25,143	18,505	43,648	.4239
1963	21,077	26,938	48,016	27,692	20,324	48,016	.4232
1964	23,246	30,038	53,284	30,625	22,659	53,284	.4252
1965	26,047	34,138	60,185	34,156	26,030	60,185	.4324
1966	29,236	38,023	67,259	37,782	29,477	67,259	.4382
1967	32,363	40,965	73,328	41,389	31,939	73,328	.4355
1968	35,690	45,758	81,448	45,448	36,000	81,448	.4420
1969	39,747	51,403	91,150	49,688	41,462	91,150	.4548
1970e	44,245	57,698	101,943	54,268	47,675	101,943	.4676
1971*	49,932	65,259	115,191	59,568	55,623	115,191	.4828

e = Estimate
* = Projection

Table 4

U.S. CORPORATIONS' FOREIGN BALANCE SHEET (End of Year) (Ex. Canada)
Millions of Dollars

	1964	1965	1966	1967	1968	1969	1970 Estimate
Direct investments	30,625	34,156	37,782	41,389	45,448	49,688	54,268
Other long-term assets	964	1,008	1,087	1,329	1,451	1,798	2,100
Short-term assets	2,258	2,213	2,646	2,900	3,678	3,424	3,600
Total Assets	33,847	37,377	41,515	45,618	50,577	54,910	59,968
Short-term liabilities	1,413	1,499	1,725	2,034	2,459	2,733	3,650
Euro-and foreign bonds	--	191	785	1,231	3,375	4,404	5,185
Other long-term liabilities	385	413	606	688	1,410	2,108	2,825
Total Liabilities	1,798	2,103	3,116	3,953	7,244	9,245	11,660
Net Assets	32,049	35,274	38,399	41,665	43,333	45,665	48,308
Annual Change		+3,225	+3,125	+3,266	+1,668	+2,332	+2,643

Table 5

U.S. CORPORATIONS' FOREIGN BALANCE SHEET, CONSOLIDATED (End of Year) (Ex. Canada)

Millions of Dollars

		1964	1965	1966	1967	1968	1969	1970 Estimate
Net fixed assets		23,246	26,047	29,236	32,363	35,690	39,747	44,245
Other assets:	Affiliates	30,038	34,138	38,023	40,965	45,758	51,403	57,698
	Parents	3,222	3,221	3,733	4,229	5,129	5,222	5,700
	Total	56,506	63,406	70,992	77,557	86,577	96,372	107,643
Liabilities & claims								
	Affiliates	22,659	26,030	29,477	31,939	36,000	41,462	47,675
	Parents	1,798	2,103	3,116	3,953	7,244	9,245	11,660
	Total	24,457	28,133	32,593	35,892	43,244	50,707	59,335
Net assets		32,049	35,273	38,399	41,665	43,333	45,665	48,308

TABLE 6

U. S. BALANCE OF PAYMENTS
Millions of Dollars

	Balance on Liquidity Basis			
	Excluding Special Financial Transactions			
Year	U.S. Gov't. Account	Private Account	Special Financial Transactions	Total
1960	-3954	-8	63	-3901
1961	-3999	925	703	-2371
1962	-3508	359	942	-2204
1963	-3339	321	346	-2670
1964	-3343	173	369	-2800
1965	-3482	2129	18	-1335
1966	-4249	1364	1529	-1357
1967	-5017	211	1262	-3544
1968	-5041	2490	2723	171
1969	-4901	-1484	-628	-7012
1970(1)	-5579	-199	484	-5283

[1] Nine months, seasonally adjusted at an annual rate. Excludes allocations of special drawing rights, $868 million at an annual rate.

Note: Totals may not add because of rounding.

TABLE 7

U. S. BALANCE OF PAYMENTS
Millions of Dollars

	Balance on Official Reserve Transactions Basis			
	Excluding Special Financial Transactions			
Year	US Gov't. Account	Private Account	Special Financial Transactions	Total
1960	-3954	499	54	-3403
1961	-3999	1957	695	-1347
1962	-3508	123	680	-2702
1963	-3339	1000	326	-2011
1964	-3343	1655	123	-1564
1965	-3482	2480	-287	-1289
1966	-4249	4188	328	266
1967	-5017	1987	-388	-3418
1968	-5041	6498	185	1641
1969	-4901	7678	-78	2700
1970(1)	-5579	-4353	389	-9534

[1] Nine months, seasonally adjusted at an annual rate. Excludes allocations of special drawing rights, $868 million at an annual rate.

Note: Totals may not add because of rounding.

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TABLE 8

U. S. INTERNATIONAL TRANSACTIONS: U. S. GOVERNMENT ACCOUNT
Millions of Dollars

	1960	1961	1962	1963	1964	1965
Goods, services and unilateral transfers						
Receipts: Exports[1]	2072	2429	2516	2918	3048	3042
Services	368	497	670	785	690	748
Income on investments	348	381	471	498	456	575
Total receipts	2788	3307	3657	4201	4194	4365
Payments: Military expenditures	3087	2998	3105	2961	2880	2952
Services	313	406	398	447	535	550
Income on investments	332	278	339	401	453	488
Grants and other transfers	1878	2088	2164	2179	2167	2177
Total payments	5610	5770	6006	5988	6035	6167
Net receipts	-2822	-2463	-2349	-1787	-1841	-1802
Asset transactions (net receipts)						
U. S. Gov't. assets[2]	-1158	-1621	-1774	-1987	-1799	-1747
Foreign assets in the U. S.	26	85	615	435	297	67
Total net receipts (excluding special transactions)	-3954	-3999	-3508	-3339	-3343	-3482
Special financial transactions (net receipts)	54	695	930	278	292	206
Balance on liquidity basis	-3900	-3304	-2578	-3061	-3051	-3276
less: Adjustments[3]	-	-	250	-48	169	123
Balance on official reserve transactions basis	-3900	-3304	-2828	-3013	-3220	-3399

[1] Includes transfers under military sales contracts.

[2] Excludes official reserve assets.

[3] Net increase in certain nonliquid liabilities to foreign official agencies. These are also included in special financial transactions.

TABLE 8 (Continued)

U. S. INTERNATIONAL TRANSACTIONS: U. S. GOVERNMENT ACCOUNT
Millions of Dollars

	1966	1967	1968	1969	1970[4]
Goods, services and unilateral transfers					
Receipts: Exports[1]	3443	3913	3900	3625	3379
Services	798	767	869	791	837
Income on investments	593	638	831	932	955
Total receipts	4834	5318	5600	5348	5171
Payments: Military expenditures	3764	4378	4535	4850	4863
Services	642	687	758	710	707
Income on investments	549	598	702	777	984
Grants and other transfers	2277	2243	2113	2050	2007
Total payments	7232	7906	8108	8387	8560
Net receipts	-2398	-2588	-2508	-3039	-3389
Asset transactions (net receipts)					
U. S. Gov't. assets[2]	-1963	-2427	-2465	-2054	-1837
Foreign assets in the U. S.	112	-2	-68	192	-352
Total net receipts (excluding special transactions)	-4249	-5017	-5041	-4901	-5579
Special financial transactions (net receipts)	397	458	2112	-225	927
Balance on liquidity basis	-3852	-4559	-2929	-5126	-4652
less: Adjustments[3]	-32	452	1806	-162	609
Balance on official reserve transactions basis	-3820	-5011	-4735	-4964	-5261

[1] Includes transfers under military sales contracts.

[2] Excludes official reserve assets.

[3] Net increase in certain nonliquid liabilities to foreign official agencies. These are also included in special financial transactions.

[4] Nine months, seasonally adjusted at an annual rate.

TABLE 9

U. S. INTERNATIONAL TRANSACTIONS: PRIVATE ACCOUNT
Millions of Dollars

	1960	1961	1962	1963	1964	1965
Goods, services and unilateral transfers						
Receipts: Exports[1]	17913	18080	18919	19991	23177	24235
Services	3384	3358	3401	3598	4213	4558
Income from portfolio investments	646	793	904	1022	1256	1421
Direct investments: income	2355	2768	3044	3129	3674	3963
Direct investments: fees and royalties	403	463	580	660	756	924
Total receipts	24701	25462	26848	28400	33076	35101
Payments: Imports	14744	14519	16218	17011	18647	21496
Services	4147	4218	4527	4875	5173	5552
Income on investments	731	729	771	924	1003	1241
Private remittances	382	397	450	536	530	581
Total payments	20004	19863	21966	23346	25353	28870
Net receipts	4697	5599	4882	5054	7723	6231
Asset transactions (net receipts)						
U. S. private assets						
Direct investment capital flow	-1674	-1598	-1654	-1976	-2328	-3468
Other	-2204	-2582	-1772	-2483	-4250	-476
Foreign assets in the U. S.	329	609	149	235	146	418
Unrecorded transactions (net receipts)	-1156	-1103	-1246	-509	-1118	-576
Total net receipts (excluding special transactions)	-8	925	359	321	173	2129
Special financial transactions (net receipts)	9	8	12	68	77	-188
Balance on liquidity basis	1	933	371	389	250	1941
plus: Foreign private liquid funds (net receipts)	498	1024	-248	620	1554	131
less: Other adjustments[2]	-	-	-	9	149	-38
Balance on official reserve transactions basis	499	1957	123	1000	1655	2110

[1] Includes transfers under military sales contracts.

[2] See footnote 3, Table 3.

TABLE 9 (Continued)

U. S. INTERNATIONAL TRANSACTIONS: PRIVATE ACCOUNT
Millions of Dollars

	1966	1967	1968	1969	1970[3]
Goods, services and unilateral transfers					
Receipts: Exports[1]	26775	28008	31083	34363	40143
Services	5063	5506	5837	6527	7400
Income from portfolio investments	1614	1717	1949	2267	2635
Direct investments: income	4045	4517	4973	5639	6021
Direct investments: fees and royalties	1030	1136	1246	1369	1536
Total receipts	38527	40884	45088	50165	57735
Payments: Imports	25463	26821	32964	35835	39408
Services	6049	6742	6939	7707	8698
Income on investments	1593	1764	2231	3686	4303
Private remittances	531	726	715	784	943
Total payments	33636	36053	42849	48012	53352
Net receipts	4891	4831	2239	2153	4383
Asset transactions (net receipts)					
U. S. private assets					
Direct investment capital outflow	-3661	-3137	-3209	-3070	-4805
Other	-683	-2560	-2082	-2148	-1797
Foreign assets in the U. S.	1331	2165	6056	4422	4061
Unrecorded transactions (net receipts)	-514	-1088	-514	-2841	-2040
Total net receipts (excluding special transactions)	1364	211	2490	-1484	-199
Special financial transactions (net receipts)	1132	804	611	-403	-439
Balance on liquidity basis	2496	1015	3101	-1887	-637
plus: Foreign private liquid funds (net receipts)	2384	1472	3810	8716	-4464
less: Other adjustments[2]	793	894	534	-834	-821
Balance on official reserve transactions basis	4087	1593	6377	7663	-4280

[1]Includes transfers under military sales contracts.

[2]See footnote 3, Table 3.

[3]Nine months, seasonally adjusted at an annual rate.

FOREIGN PETROLEUM AFFILIATES OF U.S. CORPORATIONS
Millions of Dollars

	1957	1958	1959	1960	1961	1962	1963
Sources:							
Net income	1,738	1,325	1,196	1,366	1,553	1,824	1,953
Funds from U.S.	1,043	529	528	454	743	340	789
Funds obtained abroad	832	623	255	153	301	506	777
Depreciation & depletion	688	830	914	957	1,099	1,095	1,123
Total sources	4,301	3,307	2,893	2,930	3,696	3,765	4,642
Uses:							
Property, plant & equipment	2,322	1,834	1,558	1,467	1,534	1,628	1,889
Inventories	265	-55	- 8	20	85	54	119
Receivables	467	167	65	164	292	296	439
Other assets	296	200	192	58	398	221	498
Income paid out	952	1,161	1,086	1,221	1,387	1,566	1,697
Total uses	4,301	3,307	2,893	2,930	3,696	3,765	4,642
Assets: (end of year)							
Current & other assets	6,550	6,862	7,111	7,353	8,128	8,699	9,755
Net fixed assets	8,200	9,204	9,848	10,358	10,793	11,326	12,092
Total assets	14,750	16,066	16,959	17,711	18,921	20,025	21,847
Claims: (end of year)							
By ownership:							
U.S. investment	9,055	9,743	10,376	10,965	11,864	12,450	13,443
Foreign investment	5,695	6,323	6,583	6,746	7,057	7,575	8,404
Total claims	14,750	16,066	16,959	17,711	18,921	20,025	21,847
By type of claim:							
Equity	8,562	9,372	9,961	10,855	11,547	12,257	13,116
Debt	6,188	6,694	6,998	6,856	7,374	7,768	8,731
Total claims	14,750	16,066	16,959	17,711	18,921	20,025	21,847

FOREIGN PETROLEUM AFFILIATES OF U.S. CORPORATIONS
Millions of Dollars

	1964	1965	1966	1967	1968	1969
Sources:						
Net income	1,872	1,891	1,926	2,173	2,516	2,580
Funds from U.S.	684	997	724	1,150	1,271	1,250
Funds obtained abroad	675	1,026	1,482	1,493	1,584	1,785
Depreciation & depletion	1,156	1,247	1,315	1,383	1,450	1,515
Total sources	4,387	5,161	5,447	6,199	6,821	7,130
Uses:						
Property, plant & equipment	2,073	2,267	2,526	3,000	3,349	3,800
Inventories	89	80	1,100	1,200	1,200	1,000
Receivables	154	399				
Other assets	156	520				
Income paid out	1,915	1,895	1,821	1,999	2,272	2,330
Total uses	4,387	5,161	5,447	6,199	6,821	7,130
Assets: (end of year)						
Current & other assets	10,154	11,153	12,253	13,453	14,653	15,653
Net fixed assets	13,009	14,029	15,240	16,857	18,756	21,041
Total assets	23,163	25,182	27,493	30,310	33,409	36,694
Claims: (end of year)						
By ownership:						
U.S. investment	14,081	15,124	16,003	17,377	18,942	20,492
Foreign investment	9,082	10,058	11,490	12,933	14,467	16,202
Total claims	23,163	25,182	27,493	30,310	33,409	36,694
By type of claim:						
Equity	14,150	14,979	16,327	17,531	18,416	19,267
Debt	9,013	10,203	11,166	12,779	14,993	17,427
Total claims	23,163	25,182	27,493	30,310	33,409	36,694

Note: Includes producing, refining, marketing and transportation.

Statement of Henry Ford II
Chairman of the Board
Ford Motor Company

I appreciate the invitation to submit a statement to this Subcommittee on International Trade of the Senate Finance Committee. The subject of your hearings is of vital importance to Ford Motor Company and the entire automobile industry.

Since 1934, every President of the United States - Democratic and Republican - has recognized the benefits that flow from expanding trade and has based his foreign trade policy on the objective of achieving freer international movement of goods and capital on a reciprocal basis through mutual agreement. Despite some growing current problems, the policy undoubtedly has been and remains the right one for our nation.

During the period since this policy has been in effect, the growth in the volume of international trade and the prosperity of the world's industrial nations has been phenomenal. As contrasted to the severely limited trade and general economic stagnation which preceded the inauguration of the reciprocal trade program, clearly the policies in effect since 1934 have benefited the entire free world.

Although trade between the United States and other nations represents a relatively small share of the U.S. gross national product, it is highly significant to our overall economy. Such trade encourages better resource allocation, specialization, and large scale production, which benefit producers and consumers. Worldwide competition disciplines prices, stimulates continual improvement of products and by encouraging technological innovation increases productivity and the real wages of labor.

At the same time, it must be recognized that there are grave risks to the country if the United States continues to follow liberal trade policies while other countries maintain nationalistic trade policies and follow currency policies that perpetuate international cost-price imbalances.

In this paper, I shall point to some of the problems inherent in a liberal trade policy, drawing heavily on the experience of the automobile industry. In addressing myself to these problems, I do not intend to condemn the basic system. On the contrary, fully recognizing its past and potential contributions to the welfare of our nation, and other industrial nations, I shall suggest ways of strengthening and preserving the flow of goods and capital between nations. In my judgment, few actions could be more detrimental to the welfare of the people of this country than to have our government reverse its liberal trade posture. In order to help avert such a possibility, however, I think it is incumbent upon friends of the system to recognize its weaknesses and actively participate in its repair.

I have the utmost confidence in the ability of American corporations and businessmen to compete successfully in world markets if they are not made non-competitive by forces beyond their control. Unfortunately they may face such a possibility in the future unless greater effort is directed toward halting run-away costs in this country and removing unfair restrictions by some of the other major trading nations.

There are many facets to international trade which need attention, but in my opinion three issues - soaring costs in the United States, restrictive practices of some of the major trading countries of the world, and international currency imbalances - must be dealt with immediately and effectively if the United States is to maintain its historic place in the world market. Let me illustrate these problem areas from the experience of the U.S. automobile industry.

Soaring Costs and Their Effect on International Competition

Between 1960 and 1970 Ford's total hourly labor costs in the United States per hour worked increased by 78 percent (this included increases in social security tax payments of 160%); in addition we experienced large increases in other costs, including other taxes. The cost per car for safety and pollution control also increased substantially.

These increases have been especially rapid since 1965. Between 1965 and 1971, the cumulative increase in costs for these factors has totalled nearly $800 per car.

In addition to restricting the overall growth of the U.S. car market, rising costs and prices have also made the U.S. auto industry increasingly vulnerable to foreign competition in the United States and abroad.

Until the 1950's, the free world auto market was composed of two main segments which, because of product differences, did not directly compete with one another. American consumers wanted and the American auto industry supplied them with large and relatively expensive cars. Foreign consumers wanted and foreign manufacturers supplied them with small and lower priced cars. Neither segment of the industry could compete effectively in the other segment's market because neither had a home market for the products desired in the other.

The two major car markets are now becoming one world market. With growing United States demand for small economy cars, a significant portion of the U.S. car market is now vulnerable to foreign competition. The imported car share of total car sales in the United States has climbed steadily from the recent low of 5.1 percent in the 1963 model year to 13.2 percent in 1970 and an estimated 16.3 percent in 1971.

The shift toward economy cars, including imports, reflects the desire of American consumers to offset the steadily rising costs of purchasing and operating a car. Additional increases in these costs will expose a still larger share of the United States market to foreign competition.

Labor costs are a major element in the costs of vehicle manufacture. In 1970, the total hourly labor cost in Ford U.S. plants averaged $6.40. The comparable figure for our plants in Germany was $3.12 and we estimate that automotive labor costs in Japan were about $1.30 per hour. Thus, Germany and Japan, the two major exporters of cars to the United States, had an advantage in labor costs, including fringes, of $3.28 and $5.10 per hour, respectively, over the United States.

Even though auto industry wages have been rising faster on a percentage basis in Germany and Japan than in the United States, the dollar difference generally has become larger. From 1960 to 1970, we estimate that although auto industry labor costs increased at an annual rate of only 5.9 percent in the United States, compared to 10.9 percent in West Germany, and 8.6 percent in Japan, the actual labor cost advantage of West German producers over U.S. producers increased by about 80¢ per hour, while the advantage of Japanese manufacturers increased by about $2.08.

The argument that higher labor costs in the United States are offset by greater volume and more efficient plants is no longer valid. Both West Germany and Japan have reached volume levels that make it possible for them to maximize efficiencies of scale.

West German and Japanese manufacturers also benefit from fewer work stoppages. In 1968, the last year for which data are available, time lost because of labor disputes in all industries averaged 73.7 man-days per hundred workers in the United States, compared to 9.1 man-days for Japan and 1/10 of a man-day for West Germany.

Steel prices are also lower in West Germany and Japan. At year-end 1970, cold-rolled sheet steel cost $188 per ton in the United States, and the equivalent of U.S. $176 in Germany, and U.S. $142 in Japan.

Foreign production and marketing cost advantages have been accentuated in recent years by the growing imbalance between currency values - particularly with respect to Germany and Japan. An appropriate realignment of currency values would substantially improve U.S. competitiveness with foreign auto makers.

Adverse international cost trends affect not only the automobile industry but many other industries as well, and it is extremely difficult to restore economic vitality once a nation's industry becomes non-competitive in world markets because of cost imbalances.

In these circumstances, it seems apparent to me that governmental policies must be geared toward making it possible for U.S. industry to reduce costs and increase productivity. First, the serious inflation that has lasted so long must be brought under control. Second, I believe that we must face up to the need for establishing priorities for national objectives, including our determination to improve the environment and increase highway safety. These are important objectives, but efforts to achieve them must give adequate weight to the impact of government policies on American business costs.

If U.S. industry is unable to meet foreign competition, as a result of imbalances in currency values, inflation and the burden of costly government programs, many basic national objectives will suffer. What is needed, I believe, is a determined governmental effort to help U.S. producers keep costs in line with those of foreign producers. This would entail a re-examination of international monetary arrangements; and on the domestic side a review of tax policy, labor statutes, regulatory activities, export incentives, and many other aspects of government impingement on industry.

Restrictions Abroad

In its desire to help restore the economic health of nations ravaged by World War II, the United States willingly adopted trade policies and practices which favored the efforts of these countries to rebuild their industries and strengthen their financial structures.

Today the industrial and financial strength of many of these nations has been restored and nations such as West Germany and Japan have become major creditors while the U.S. balance of payments has reached a near critical stage. Obviously it is time for trade agreements which are genuinely reciprocal.

The agreement on tariff reductions in the 1967 Kennedy Round of the General Agreement on Tariffs and Trade (GATT) was a major step in promoting the expansion of world trade. Many believed we had jumped the last major hurdle and the way toward maximizing growth and stability in international trade had been found. However, experience has shown that additional efforts are needed if we are to achieve maximum growth and stability in our own and the world economy. Although many tariff rates were reduced in the last GATT round, the non-tariff barriers were left virtually untouched. GATT now has officially

before it some 800 complaints over non-tariff barriers, including many against the United States. These complaints should be the basis for new multinational negotiations.

In some instances even a substantial cut in duties has done little to expand foreign markets to imports from the United States. Their duties remain higher than those of the United States and this factor, along with their non-tariff barriers, has been sufficient to prevent any significant inroads by foreign competition.

To be more specific, the U.S. duty on all passenger cars imported into the U.S. after December 1971 will be 3 percent while in the European Economic Community and in the United Kingdom it will be 11 percent. The rate in Japan probably will remain at the current 10 percent. Duty rates on cars in most other countries are well above these levels.

In our industry, foreign governments often resort to non-tariff barriers to protect their markets from foreign competition. For example, foreign investment in the Japanese automobile industry continues to be severely restricted by governmental policy and until Japan substantially reduces its restrictions on foreign car imports and on investments in its automobile industry, outside manufacturers will have little hope of gaining the freedom to do business in that market equal to the freedom the Japanese enjoy in the United States and other markets of the world.

The United States should intensify its efforts to obtain more equitable tariff treatment for U.S. products, and the removal or appropriate modification of non-tariff barriers, especially in those areas where these restrictions add to a competitive advantage derived from basic economic factors.

Multinational Corporations

An aspect of international trade which has received much attention recently is the so-called multinational corporation. Some nations are studying possible further regulation of the multinational corporation, which has been for decades the backbone of international trade. Some consider multinational corporations a recent innovation in world trade, and describe them as selfish economic giants which run roughshod over national governments. In truth, there is nothing new about multinational corporations but the name by which they are now described. Most such corporations, United States and foreign, serve well the economies of multiple host nations and have learned to live - not above and beyond - but properly and appropriately within the laws and customs of the host countries.

Often the multinational corporation is considered an invention of the United States, but it certainly is not an exclusively U.S. phenomenon. As a matter of fact, multinational corporations based in Europe played an important role in the early development of the United States.

According to one recent estimate, about 80 of the 200 largest American companies have more than one-fourth of their sales, earnings, assets or employment outside of the United States. Among the 200 largest European companies, there are also about 80 which have the same proportion of their business outside of their home countries. Companies with such familiar names as Shell, Unilever and Philips are among the largest in the world and are major factors in the United States market. Most Americans who buy their products are not even aware that they are European multinational companies.

Almost since its creation Ford Motor Company has been what is today termed a multinational corporation. It was incorporated in 1903 in the United States and in the second year of its corporate life moved into international operations. In August 1904 - nearly 67 years ago - the company's first foreign subsidiary, Ford of Canada was incorporated and it shipped its first car six months later, in February 1905.

Ford's first assembly plant outside North America was established in Manchester, England in 1911 - 60 years ago - and we have been a corporate citizen of many other countries for almost half a century.

Today we manufacture or assemble cars, trucks or tractors in 21 countries, and we have sales companies in eight others. We supply dealer assemblers in 11 nations and dealers in about 100 more. Profits returned to the United States from Ford's foreign operations over the years have contributed billions of dollars toward the U.S. balance of payments largely from supplying markets which were substantially closed to exports from the United States because of various restrictive barriers or competitive factors.

In the mid-1920's Ford had a major reorganization in Europe largely as the result of hostility toward foreign-owned companies and a general protectionist trend in Europe. Thereafter protectionist pressures continued to build and several nations drastically increased tariffs, imposed import quotas and restricted money transfers.

Adding fuel to the fire, in 1930 the United States enacted the Smoot-Hawley Tariff Act and, as many experts predicted, France, Italy and other European nations retaliated with a vengeance, particularly against foreign car manufacturers.

Perhaps Ford Motor Company's experience of being caught up in a vicious trade war contributes to our deep concern over the signs of protectionism today which seem to parallel those of that earlier era. Our concern grows when it appears that the United States might make the same mistake it did in 1930, with even more devastating results.

Multinational corporations sometimes are caught in conflicts between national governments on matters such as anti-trust, export controls, monetary transfers, and the like, but as in the past, I think these conflicts will occur infrequently enough to permit the nations involved to work out mutually acceptable solutions. The present trend in the United States toward reducing the number of restricted items on the export control list will reduce international friction from this source. However, the United States should carefully review the application of its anti-trust policies to the foreign subsidiaries of U.S. corporations. Some of these policies are not only detrimental to U.S. companies but are also a source of irritation to foreign governments. A forum for discussions regarding conflicts between nations, such as the OECD or, as proposed by many experts, a GATT-like organization, possibly could serve a useful purpose, but placing a straightjacket on multinational corporations through governmental controls would create far more problems and conflicts than it would solve.

Summary and Conclusions

Certainly there are serious problems in international trade which are of vital concern to the United States, but I continue to believe that solutions must be found within a framework that will provide lower rather than higher barriers to international trade and investment.

We face one of the greatest challenges in our history and this challenge will not be met by building a trade wall around the United States. In my judgment, three things should receive immediate attention. First, we must get our own economic house in order to enable us to compete aggressively in the world markets of today. Second, we must use the tools already available to open the markets of the world on a fair and reciprocal basis. Third, we must achieve a better relationship among international currency values.

The first goal can be reached only through tough, economic discipline in government, labor, and industry. Government must become more efficient and economical itself and must do what is necessary to halt inflation. Wage increases must be matched by productivity gains. Management must become more efficient and more responsive to customer needs.

The second goal, requires an equally tough stance toward discriminatory trade and investment practices by other nations.

The third goal requires that the United States take the initiative in working toward changes in international monetary arrangements that would permit greater flexibility in exchange rates.

STATEMENT OF FREEPORT MINERALS COMPANY*
TO THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE, U.S. SENATE

JUNE 15, 1971

Testimony presented to the subcommittee has dealt with the question of whether national trade policies and international rules and institutions are adequate in light of the changing conditions in the world. This memorandum will focus on one area of change in the world economy with which existing law is not adequate to deal.

* * *

In the United States and throughout the world, man's need for minerals has grown at an extremely rapid rate during the last three decades. While production has -- with few exceptions -- kept pace, the simple and higher quality sources for these minerals are becoming exhausted, causing increased reliance upon more complex and lower grade mineral sources. Technologies have been improved to permit the separation and recovery of a number of different mineral components from these complex sources.

Removal of one or more components from a mineral source is sometimes necessary in order to make another component saleable to a consumer. In the past, the components removed were often discarded. Today, in many cases, they may be recovered as other valuable products. The growing emphasis on the protection of the environment, and the economic need to recover all valuable components, make it virtually impossible to discard any major component today and, consequently, recovered products are entering the marketplace at an increasing rate.

Submitted by E. Bruce Harrison, Vice President

Because one mineral component is often in great demand at a given time and will bring a premium price, other component products are often sold at very low prices -- prices which relate neither to the costs of recovering and producing the product nor to the existing market for the product. For all practical purposes, the producer is using the proceeds from one product, while it is in high demand, to subsidize the movement of a less desirable product.

When the second product is produced in a foreign country and is imported into this country to be sold at these unreasonably low prices, the effect can be severe injury to a domestic industry producing the product as a primary product. The domestic industry can be badly crippled and in extreme cases eliminated. Then, if the conditions affecting the foreign mineral production and marketing change and the foreign supply is cut back or made available only at very high prices, our national economy suffers. Existing legislation is not adequate to deal with this problem.

This company is faced with such a problem in the form of sulphur produced in foreign countries as a component of sour natural gas, and we can attest both to the injury and to the inadequacy of existing law to provide effective relief. Additional problems, involving other products and other mining industries, will develop from this time forward as industry and national demands encourage the development of more and more complex mineral sources. We urge the subcommittee's assessment of current law and policy in view of changed -- and still-changing -- economic conditions and trade practices associated with mineral products derived from complex mineral sources.

EBH/gt

UNITED STATES-JAPAN TRADE COUNCIL

1000 CONNECTICUT AVENUE, WASHINGTON, D. C. 20036 / 296-5633 Cable TRADETIES

June 23, 1971

The Honorable Abraham A. Ribicoff
Chairman, Senate Finance Committee
Subcommittee on International Trade
Old Senate Office Building
Washington, D. C. 20515

Dear Senator Ribicoff:

The following letter is submitted on behalf of the United States-Japan Trade Council, 1000 Connecticut Avenue, N.W., Washington, D. C. 20036. The Council is a trade association concerned with the development of trade and investment between the United States and Japan and with the progressive elimination of the current tensions between the two nations which now appear to occupy much too prominent a place in their relations.

The initial hearings conducted last month by the Senate Finance Committee's Subcommittee on International Trade performed the very useful function of allowing a legislative committee to take a longer-term view of American trade policy for the 1970's. When specific, pending legislation is under consideration, it usually is difficult to focus on broader and emerging issues. This is especially unfortunate when foreign trade legislation is under consideration. Postwar American trade policy is clearly at an important crossroads.

If American trade policy is going to be changed to reflect the international economic realities of the 1970's, a broad perspective is necessary. The stakes are high and the issues are complex. Objective deliberations, such as your Subcommittee's hearings last month, are necessary. In our opinion, your basic thesis that the U.S. trade policy must shift from a geopolitical to an ecopolitical basis is entirely sound. It is necessary, therefore, to seek a policy shift which contains a maximum amount of good economics.

To determine what is good economics for U.S. trade policy in the 1970's, two key questions must be answered. The first is the relative impact of imports on the American economy. The numerous, loud and prolonged pleas by certain segments of American business and labor belie the fact that imports directly compete with only about 2.5 percent of total U.S. production. Total imports represent only four percent of U.S. GNP; imports of raw materials, agricultural

The UNITED STATES-JAPAN TRADE COUNCIL, INC., is a non-profit trade association with a membership of over 700 firms in the United States interested in fostering trade relations between the two countries. Because a substantial contributing member, the Japan Trade Promotion Office, 39 Broadway, New York, New York, is financed by the Japanese government, the Council is registered with the Department of Justice under provisions of 22 U.S.C. Sec. 611 et seq. as an agent of such foreign principal. Copies of the Council's registration statement are available for public inspection in Department of Justice files. Registration does not indicate approval of the contents of this communication by the United States Government.

goods, and manufactured specialty items either not produced at all or in limited quantities in this country represent at least 30 percent of total imports. Nonetheless, a means of redress for the minority injured by a U.S. policy of liberal trade is in order. The question which must be resolved by this country's policy makers is whether this minority can be properly aided and at reasonable costs in a positive manner, without jeopardizing the imports wanted and needed by American industry and the American consumer. It is our belief that even at the temporarily high rates of import growth, the various existing forms of relief from rapid import increases and unfair methods of foreign business competition can protect U.S. interests in a satisfactory and adequate manner.

The second key trade question to be resolved is the significance of exports. Although a trade surplus is often hailed as proof of a successful economic policy, the often ignored fact remains that exports are only a means of paying for imports, the ultimate rationale for engaging in international trade. There are two factors which will hamper a U.S. export growth rate commensurate with its import growth rate. In the first place, the United States is increasingly becoming a service-oriented economy; the production of goods is steadily becoming a less important factor for the U.S. labor force and GNP. Secondly, American industry is increasingly servicing foreign markets through overseas production, rather than direct export. We would submit that a thorough reconsideration of the significance of U.S. exports (and a U.S. trade surplus) in the changing economic realities of the 1970's is called for.

On the export side, innovations are necessary to retain existing levels of U.S. international competitiveness at a time when other economies are becoming sophisticated and when technology is becoming internationalized. On the import side, however, two fundamental economic facts remain unchanged. First, the American economy is centered on the concept of competitiveness and the open market. Fair foreign competition is a vital ingredient in this process; unfair competition can be dealt with by existing statutes. Secondly, American imports are another country's exports, i.e. the latter's means of paying for U.S. exports.

It is our hope that the International Trade Subcommittee will continue to examine the extremely complex question of what trade policy mix will best serve the long-term national interests of the United States in a changing international economic environment.

Japanese Trade Policies

Japan's trade policies continue to be the subject of extensive criticism in this country. As recently as two or three years ago, most of these criticisms had some foundation. However, the relatively sudden development of Japan's ability to compete effectively in the world marketplace has necessitated a wholesale dismantling of import

curbs which were necessary in the postwar period for balance of payments reasons. A casual observer of Japan is hard pressed to keep up with the swift moving pace of Japanese trade and investment liberalization in recent months. To bring this record up to date, I am enclosing for the record recent publications by the United States-Japan Trade Council, as well as a speech by the Japanese Ambassador to the United States, Mr. Nobuhiko Ushiba and a speech made recently in Washington by the President of the Japanese Federation of Economic Organizations, Mr. Kogoro Uemura.* Above all, we urge the Finance Committee to take cognizance of the dynamic--and one-way--movement of Japan towards international economic liberalization.

Finally, I would like to set the record straight on a number of points raised concerning Japanese trade policies during last month's subcommittee hearings. In Chairman Ribicoff's opening remarks, he said that "Japan's steel production will surpass that of the United States by next year . . . ." In the view of most professional observers, Japan's steel production will still be below this country's production, at least as late as 1975.

The Japanese steel industry, like the steel industry of any industrialized country, is faced with competition for funds, spiraling raw material cost, a relatively dwindling labor force, and the high costs of pollution control. These factors must cast substantial doubt on forecasts of unimpeded production growth.

On page eight of the statement by Mr. Nathaniel Samuels of the State Department, it is said that Japanese quota restrictions will be down to about 80 from 122 of two years ago. While Japan currently has 80 items under restriction, the number is scheduled to decline to 40 by the end of September of this year. When this happens, Japan will have more goods under "voluntary" export restraint than under import quota.

On page 13 of the statement by Mr. Joseph Wright, Chairman of the Zenith Radio Corporation, Japanese workers were said to be making 73 cents an hour, excluding bonus and benefits. In a country like Japan, where an annual or semiannual bonus is regularly paid, fringe benefits must be included to permit an undistorted picture of labor costs. Mr. Wright also implies that Japan has restrictions on large-size televisions. There are no such barriers against American TVs. He also says that Japanese government regulations still block the entry of spare parts. This is completely untrue.

On page 20 of his testimony, Mr. Wright suggests that the remission of commodity taxes by Japan and other nations represents a subsidization of exports. According to current interpretations of GATT rules, the remission of an indirect tax is not an infringement of GATT and is not considered a subsidization of exports. The United States exempts states sales taxes on exports. This is of the same legal nature as the remission of commodity taxes by other countries.

*These documents were made a part of the official files of the Committee.

In general, the Zenith Company's frustrations with the Japanese TV market reflects conditions of several years ago.

Mr. Fred Borch's testimony contains a technical defect in that he compares export price indices with consumer price indices. The export price index should more appropriately be compared with wholesale price indices. Exporting companies pay wholesale prices for their raw materials, not retail prices. In addition, retail price indices include the costs of services, which are not involved in international trade. The disparity between Japanese export price and domestic wholesale price indices is relatively narrow; indeed, Japan's disparity is not as wide as in some other industrial countries. On page 16, Mr. Borch compares tax incentives in Japan with those of the United States. The serious flaw in this comparison is that the material which he used is outdated. For instance, the entertainment expenses allowances are now abolished completely; other tax incentives are largely reduced in size.

The United States-Japan Trade Council is prepared to supply any necessary information on this or other aspects of the U.S.-Japan relations on request from the Committee.

Sincerely yours,

Nelson A. Stitt

Nelson A. Stitt
Director

NAS:hk

Summary Statement

before the

Subcommittee on International Trade

of the

Senate Finance Committee

HEARINGS ON MAJOR INTERNATIONAL

ECONOMIC PROBLEMS

MAY 17-21, 1971

OBSERVATIONS ON AMERICAN TRADE POLICIES INCLUDING THE POSITION OF THE AMERICAN FOOTWEAR MANUFACTURERS ASSOCIATION ON FOREIGN TRADE

Statement of

Iver M. Olson

Senior Vice President and Chief Economist

American Footwear Manufacturers Association

FIXED EXCHANGE RATES ARE A FUNDAMENTAL CAUSE OF U.S. TRADE PROBLEMS.

The explosion on the European currency markets during May, 1971, brought to a head the net effects of having fixed exchange rates geared to the U.S. dollar, and its value, in turn, pegged to a fixed value of gold -- all started under an international agreement made in Bretton Woods, N. H., in 1944. This exchange rate decision was pretty much forced on Americans, Europeans and other trading nations. Many of them disliked exchange controls because they interfered with the free market. The controls, however, greatly helped our trading partners recover from the effects of World War II and grow strong industrially in the following 25 years. But in recent months the fixed exchange rates that favored the exports of these nations also forced them to absorb more dollars, with a consequent burgeoning of their money supplies and accompanying inflation.

From the American viewpoint it has meant an unjustly competitive situation, manifest in ever-mounting increases in imports. Lower wage rates abroad, irrelevant under free, floating and flexible exchange rates, became very relevant under fixed rates. Also, the artificial valuing of currencies resulted in general price levels that benefitted foreign goods in relation to American products.

But most Americans, including many economists who should have known better, have lived with their heads in the sand. There were a few exceptions. The economist Milton Friedman of the University of Chicago saw a long time ago that fixed exchange rates would result in painful dislocations, adjustments and patchwork remedies. Friedman saw that such a system could not allow the international economy to move definitively toward the ultimate goal of free trade.

He said: "A system of floating exchange rates would therefore enable us to proceed effectively and directly toward complete free trade in goods and services - barring only such deliberate interference as may be justified on strictly political and military grounds; for example, banning the sale of strategic goods to communist countries. So long as we are firmly committed to the straitjacket of fixed exchange rates, we cannot move definitively to free trade. The possibility of tariffs or direct controls must be retained as an escape valve in case of necessity.

"A system of floating exchange rates has the side advantage that it makes almost transparently obvious the fallacy in the most popular argument against free trade, the argument that 'low' wages elsewhere make tariffs somehow necessary to protect 'high' wages here. Is 100 yen an hour to a Japanese worker high or low compared with $4 an hour to an American worker? That all depends on the exchange rate. What determines the exchange rate? The necessity of making payments balance; i.e., of making the amount we can sell to the Japanese roughly equal to the amount they can sell to us."1/

Mysteriously, the U.S. Department of Commerce, perhaps, abetted by each Administration and the State Department saw fit to ignore the bad realities of fixing exchange rates. Its economists who would not dream of fostering the fixing of prices within our economy are nonetheless for fixing the prices of exchange in the international money market. Incredible.

1/ Milton Friedman, "Capitalism & Freedom," p.71, the University of Chicago Press, Chicago, Ill., 1962.

THE U.S. GOVERNMENT FOSTERED AN ILLUSION.

To keep the illusion that all was well, our government published monthly -- and still does -- trade balance figures that indicate dollar trade balances in our favor; that is, until May 28, 1971, when even with "loaded" figures, the U.S. Department of Commerce had to report, as the "New York Times" put it, "a rare import surplus in April of $214.7 million." Simply put, even with the inclusion of phony export values averaging around $200 million monthly, the outgo of cash for imports exceeded the incoming receipts from exports.

On February 6, 1971, the General Accounting Office disclosed that the United States holds more than $1.5 billion in foreign currencies that can be spent only in a trickle. In Indian currency alone the government holds $678 million, enough to last for 19 years at the allowable current rate of spending.

The United States has amassed the Indian rupees through American food and economic assistance programs. Commodities and equipment are sold in India but the rupee payments for them are kept there. This money can be used only in India and cannot be used to buy goods for export. They can be converted into other currencies only in small amounts. U.S. government agencies cannot spend the excess rupees unless the dollar equivalent is appropriated by Congress.

Also, the government must buy the rupees at the official rate of exchange which is usually less favorable than the current market rate. This adds to the piling up of unspendable rupees.2/

What has all this got to do with our trade balance? Plenty, because we include the dollar equivalent of the rupees in our export figures, thus, overstating our trade surpluses or understating our trade deficits.

2/ Richard Halloran, "The New York Times," February 7, 1971.

In early January, the U.S. Department of Commerce forecast that the trade surplus this year could be as low as $2.2 billion, compared with $2.7 billion for 1970.3/ In this public announcement, just as in all its news releases about our nation's imports, exports and trade balances over the past two decades, the Department of Commerce has hidden the fact that its export figures includes AID giveaways*, and Public Law 480 exports** that are paid for in foreign currencies. It does circularize within the Department a monthly report "Trends in U.S. Foreign Trade," that does reveal AID and P.L. 480 exports, but is loath to send it to outsiders even though it has been referenced in FT 990, a statistical monthly publication on foreign trade.

Thus, the U.S. trade accounts are always painted in a rosy hue, and the newspapers innocently pass it on to their readers.

Consequently most Americans today -- businessmen, economists, Congressmen and the man-in-the-street -- have not been aware of our continuous deficit balance-of-trade and that this has generated, in turn, our continuous deficit balance-of-payments. Instead, they blame the flights of capital to higher yield areas and other transactions as the cause. These are more the result of the inequities and imbalances brought on by fixed exchange rates.

As a result, very few have seen fit to question the wisdom of fixed exchange rates.

3/ George W. Telfer, "Journal of Commerce," January 18, 1970.

* Exports under the "Foreign Assistance Act." Disbursement figures are supplied by the Agency for International Development.

** Agricultural Trade Development and Assistance Act of 1954," as amended. Statistics are supplied by the Department of Agriculture.

From 1965 through 1970, the U.S. Department of Commerce reported a yearly surplus in our balance of trade that ranged from $837 million to $2,270 million. These figures reflect the value of U.S. exports less only military grant-aid shipments as valued by the Department of Defense (plus 5% added by the Bureau of Census for estimated transportation costs to the port of shipment). AID loans and grants and Public Law 480 exports were kept in the exports total, thus inflating it. They are not bona fide commercial transactions for which we receive payments in U.S. dollars.

If they were properly excluded from exports, the trade balance figures would be lower by $2 to $2.5 billion in each of the six years. Thus, for example, we actually had a deficit commercial balance of trade in 1968 of $1.5 billion and in 1969 of $722 million. For details, see the appended table, especially sections marked "A" and "B."

These estimates of the deficit commercial balances are very much in line with those of Michael Boretsky of the Office of Policy Development, Office of the Secretary, U.S. Department of Commerce. For 1968 and 1969, his estimates of the commercial balances are -$1,304 million and -$582 million, respectively.4/

The U.S. Department of Commerce uses another practice that tends to gild the lily. It values the imports segment at its F.O.B. foreign point of shipment value, and exports on an F.O.B. or F.A.S. point of shipment value. For trade purposes, most nations estimate their trade balances by subtracting imports at their c.i.f. value--which includes the cost of insurance and freight from the shipping nations--from their exports at F.O.B. (F.A.S.) value.5/

4/ Michael Boretsky "Concerns About The Present American Position In Foreign Trade." A paper before the National Academy of Engineering Symposium Technology and International Trade, October 14-15, 1970.

5/ Foreign Trade Division, U.S. Dept. of Commerce, "Highlight of U.S. Export and Import Trade, FT 990," September, 1970, pp. III-IV.

If the U.S. Department of Commerce did likewise, in addition to subtracting AID and P.L. 480 shipments, it would have shown deficit trade balances for each of the past five years ranging from $186 million to nearly $3,500 million. For details, see section C of the attached table.

These estimates are conservatively below those of Senator Russell Long, Chairman of the Senate Finance Committee. In a statement before the Senate on May 11, 1971, he estimated the 1970 commercial balance of $3,200 million after the adjustments for c.i.f. and non-commercial exports; for 1969, $4,400 million, and for 1968, $4,700 million.6/

In defense of its practices, the Department of Commerce states its case as follows:

"The export statistics published by the Bureau of the Census are intended to measure the physical movement of all merchandise out of the U.S. customs area, except that to U.S. Armed Forces abroad for their own use, without regard to method of financing. To meet a need for estimates of the value of that part of our total exports which moves under the Foreign Assistance Act and Public Law 480, the following information on exports financed under these programs has been assembled from data developed by the three agencies responsible for the major programs."7/

It would seem to me that the "physical movement" which the Census data "are intended to measure" do not realistically reflect dollar trade balances if they are, as stated, made "without regard to method of financing." The dollar exchange is, after all, what the problem is all about.

6/ Russell B. Long, "Congressional Record," Vol.117, No.68, May 11, 1971, pp.S6580-S6590.
7/ Op, cit., p. 111

The Census' rationale for an F.O.B. valuation of imports is somewhat more credible, although it too raises some questions. Here is its explanation in FT 990:

> "NOTE: The f.o.b. port of export estimates provide U.S. import data in terms of the foreign port of exportation equivalent of the transaction value. The c.i.f. U.S. port of entry estimates provide U.S. import data on a value basis comparable with the import data of most foreign countries. Readers interested in calculating the U.S. trade balance should be aware that this balance can be derived only by relating exports and imports valued on the same basis."8/

In addition, Census goes on to explain that estimated c.i.f. values are "defined as the cost (to the U.S. importer) of the commodities at the foreign port of exportation, plus insurance and freight to the U.S. port of entry, regardless of whether earned by a U.S. or a foreign firm.

This raises the question as to the proportion of insurance and freight charges that are paid to foreign and to U.S. shipping and insurance companies. According to Senator Russell B. Long, Chairman, Senate Finance Committee, only about 6% of U.S. foreign trade are carried by U.S.-flag vessels. Obviously, the U.S. government should value its imports on a c.i.f. basis and President Nixon has reportedly approved this new manner of reporting, over the objections of his economic aides.9/

8/ Op. cit., p. III
9/ Senator Russell B. Long, Op, cit., p.S6583

The whole point of all this is to demonstrate that we have been misled into thinking that the fixed exchange rate system has been effective. Through the device of phony statistics about our trade balance, the government has led us to believe all was well with the fixed rate system; that this system overcame an alleged hampering effect that flexible rates would have on trade and investment; that is, until recently, when it announced the "rare import surplus in April."

A floating exchange rate for Canada in the last year and from 1950 to 1962 "had not had the feared bad effects of 'instability of the rate caused by perverse speculation, instability of prices among traded goods and an alleged depressing effect on trade and investment.'" Also, "the current German experience with a floating mark, and no fixed time limit for a return to a fixed exchange rate, will add to the evidence on this issue."10/

Milton Friedman has stated the case eloquently: "Being in favor of floating exchange rates does not mean being in favor of unstable exchange rates. When we support a free price system at home, this does not imply that we favor a system in which prices fluctuate wildly up and down. What we want is a system in which prices are free to fluctuate but in which the forces determining them are sufficiently stable so that in fact prices move within moderate ranges. This is equally true of a system of floating exchange rates. The ultimate objective is a world in which exchange rates, while free to vary, are, in fact, highly stable because basic economic policies and conditions are stable. Instability of exchange rates is a symptom of instability in the underlying economic structure. Elimination of this symptom by administrative freezing of exchange rates cures none of the underlying difficulties and only makes adjustments to them more painful."11/

10/ Edwin Dale, "N. Y. Times," June 7, 1971, page 51
11/ Friedman, Op, cit., p.69

What has this got to do with the shoe industry? This is, perhaps, already too evident.

The U.S. footwear industry is 25% to 35% more efficient in terms of productivity per man hour than the European and Japanese industries. But, via the mechanism of fixed exchange rates, unreal currency values and foreign labor cost advantages are almost completely translated into a wholesale price advantage for imported footwear in our market.

There are other basic economic inequities among the nations, but if we are going to use a systems approach, here is where we should start in developing a realistic trade policy. Otherwise, the doctrine of comparative advantage seems footless and, as a goal, totally unattainable for those of us who wish to liberalize trade.

AMERICAN FOOTWEAR MANUFACTURERS ASSOCIATION'S POSITION ON FOREIGN TRADE

Free trade is supposed to operate within the context of certain conditions. These conditions include free-floating exchange rates, absence of trade barriers except in cases of national health and defense, roughly parallel marginal productivity rates, common monetary and fiscal policies, no special tax privileges or subsidies and uniform anti-trust laws. Absence of these conditions are constraints that have molded AFMA's position. That position is to have reasonable trade legislation that enables the domestic industry to maintain stability and to share in the growth of the U.S. market.

U.S. FOREIGN TRADE BALANCE (IN MILLIONS OF DOLLARS)

1965-1968 ARE NOT SEASONALLY ADJUSTED. 1969 & 1970 ARE SEASONALLY ADJUSTED

	Est. 1970	1969	1968	1967	1966	1965
EXPORTS						
GROSS VALUE OF EXPORTS - F.O.B. (F.A.S.).....	43,360	38,006	34,636	31,526	39,320	27,478
MILITARY GRANT-AID.....	560	674	573	592	940	779
*EXPORTS EXCL. MIL. GR-AID.....	42,800	37,332	34,063	30,934	29,380	26,699
AID LOANS & GRANTS.....	990	993	1,056	1,300	1,186	1,140
PUBLIC LAW 480.....	1,086	1,018	1,178	1,237	1,306	1,323
EXPORT VALUE (LESS MILITARY GRANT-AID, AID LOANS & GRANTS, AND PUBLIC LAW 480).....	40,724	35,321	31,829	28,397	26,888	24,236
IMPORTS						
*U.S. GENERAL IMPORTS - F.O.B.....	40,000	36,043	33,226	26,889	25,618	21,429
U.S. GENERAL IMPORTS - C.I.F.....	42,520	38,314	35,319	28,583	27,232	22,779
*A. AS REPORTED BY GOVERNMENT:						
EXPORTS (LESS MIL. GRANT-AID).....	42,800	37,332	34,063	30,934	29,380	26,699
LESS IMPORTS @ F.O.B.....	40,000	36,043	33,226	26,889	25,618	21,429
BALANCE (+ OR -).....	+2,800	+1,289	+ 837	+4,045	+3,762	+5,270
B. EXPORTS (LESS MIL. GR-AID, AID, & P.L.480)	40,724	35,321	31,829	28,397	26,888	24,236
LESS IMPORTS @ F.O.B.....	40,000	36,043	33,226	26,889	25,618	21,429
BALANCE (+ OR -).....	+ 724	- 722	-1,397	+1,508	+1,270	+2,807
C. EXPORTS (LESS MIL. GR-AID, AID & P.L.480)	40,724	35,321	31,829	28,397	26,888	24,236
LESS IMPORTS @ C.I.F.....	42,520	38,314	35,319	28,583	27,232	22,779
BALANCE (+ OR -).....	-1,796	-2,993	-3,490	- 186	- 344	+1,457

Source: Compiled by AFMA from U.S. Dept. of Commerce-Census publications: FT990 and "Trends in Foreign Trade."

U.S. Trade Balance Off Sharply in April

THE NEW YORK TIMES,

FRIDAY, MAY 28, 1971

Record Imports Result in First Surplus Over Exports Since 1969

By EDWIN L. DALE Jr.
Special to The New York Times

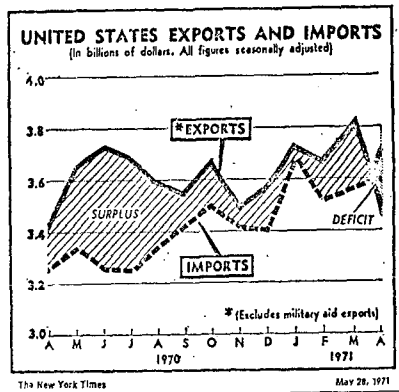
WASHINGTON, May 27—The United States trade balance deteriorated sharply in April, the Commerce Department reported today.

There was a rare import surplus in April of $214.7-million, the first such monthly surplus since February, 1969. In March there was an export surplus of $245.4-million, meaning that the trade balance worsened between the two months by about $460-million.

While one month does not establish a trend, the poor figures occurred at a bad time. There has been a renewal of international discussion and concern about the long-standing deficit in the over-all United States balance of international payments in light of the recent international monetary disturbance.

An improvement in the export-import trade balance is almost universally regarded as the key to a solution of the deficit in the balance of payments. Instead, the trade balance got worse.

Imports rose to a record total of $3,757,800,000 in April, almost $200-million higher than in March. Exports dropped about $270-million to $3,543,100,000.



There is growing criticism in Congress, led by Senator Russell B. Long, Democrat of Louisiana, that the trade figures—poor as they were for April—make the picture look better than it really is. This is because imports are recorded without including insurance and freight, and exports include shipments financed by Government foreign aid. With adjustments for these factors, last year's $2.7-billion export surplus would have disappeared.

This question divides the experts, though most Government officials believe the figures as now presented give a fair picture. Senator Long, chairman of the Finance Committee, is pressing for legislation that would require the publication of the figures each month on both bases of calculation.

Regardless of this issue, there was no dispute that the April figures worsened badly.

Officials said they believed the April results were an "aberration" and did not expect a continuation of import surpluses.

Some Administration economists pointed out that the poorer trade figures were likely to increase sentiment in Congress for limiting imports. However, the present prospect is for no trade legislation this year.

The figures should also improve the chances of legislation, now at the hearing stage in the House, to make major improvements in the availability of credit to finance export shipments.

German Trade Surplus Dips

WEISBADEN, West Germany, May 27 (Reuters)—West Germany's trade surplus narrowed to 1.067-billion marks in April from 1.885-billion in March and 1.121-billion in April, 1970, the Federal Statistics Office reported today.

The trade surplus in the first four months rose to 4.720-billion marks from 4.074-billion marks in the like period last year, the office added.

STATEMENT OF THE
NATIONAL ASSOCIATION OF MANUFACTURERS
ON
TRADE, TAX AND INVESTMENT POLICIES
SUBMITTED TO
THE SUBCOMMITTEE ON INTERNATIONAL TRADE
SENATE FINANCE COMMITTEE
UNITED STATES SENATE

June 15, 1971

The National Association of Manufacturers appreciates the opportunity to state its views on certain trade, tax and investment issues being considered by the Subcommittee on International Trade. The Association is a voluntary organization of industrial and business firms, large and small, with members located in every state and representing the major part of manufacturing output in the country.

The bulk of this statement is directed to several issues of taxation and foreign investment where we think Congress should act now to provide a better policy climate for recognized national objectives. By way of introduction, we would like to comment briefly on some background issues.

In our view, the purpose of foreign economic policy is to provide a consistent framework in which international trade and investment can flourish to the mutual benefit of the peoples involved. This is a simple statement of purpose which is obviously far more difficult to implement than to declare. However, when we have not paid attention to devising or maintaining such a consistent framework and instead have relied on patchwork responses to various crises, the country's position has suffered -- as exemplified by the ill-conceived controls on foreign investment.

We are heartened by indications of broader perspective being taken both within the Administration, particularly with the appointment of Mr. Peter G. Peterson as Assistant to the President for International Economic Affairs,

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and by the Committee on Finance with the creation and activation of this Subcommittee. The breadth of the subjects covered by testimony at these hearings, in itself, is helpful for developing a proper overview. We sincerely hope that the results of this re-examination of the foreign economic policy, both by the Administration and by Congress, will emphasize an integrated, rather than a piecemeal, approach to the problems of world trade, taxation and investment.

Our basic ability to compete abroad will depend on the productivity of our work force -- both at the production and management levels -- and how well we control our costs of production. In the late 1960's and last year, trends in these key factors were not favorable. Productivity growth sagged and inflation accelerated. Furthermore, though rates of inflation may be even higher in some key competitive nations abroad, the actual effect on export prices has been far more pronounced for U.S. products, mainly because of our much higher cost base.

Thus, getting our domestic house in order -- winding down inflation, gaining better control over unit labor and other costs -- has compelling international implications and must be constantly kept in focus in the formulation of foreign economic policy. This has been urged often and from many quarters. Yet it bears repetition and emphasis because the temptation in the past has been to ignore or downplay the fundamentals and attempt to solve balance-of-payments problems with short-term expedients.

One basic reform we consider fundamental for raising domestic productivity and staying competitive internationally over the long-term, already has been initiated earlier this year. Our depreciation practices are years out of date, and a major overhaul is very much in order. The Asset Depreciation Range (ADR) system, when implemented, will be a significant step in this direction though

it still does not achieve the degree of rapid capital recovery enjoyed by our principal foreign competitors. Exploration of further means to modernize our capital recovery policies will be welcomed by the business community.

Foreign Investment Policy

Direct U.S. private investment abroad over the post-war period has made a net contribution of $22 billion to our balance-of-payments position and has become one of the single most important supports of that position. The $22 billion represents the excess of repatriated earnings from, over the total amount of dollar outflows for, direct investment abroad.

This salient fact about the private business role abroad keeps getting lost in the arguments and policy-making procedure, particularly, of course, when the investment controls were instituted. Even now, we hear new calls to penalize the private investment sector, to place new tax burdens on it and stop it from expanding overseas market opportunities, in the name of "protecting" the balance-of-payments and jobs in the United States.

One thing that there is agreement on is that U.S. investment abroad has become a very significant factor in world business. In fact, after the U.S. domestic economy and the Common Market domestic economy, it is the largest economic element in the free world. It has largely supplanted government economic aid as an effective means of raising living standards abroad.

Private capital from the U.S., as a key factor in worldwide economic development at no cost to the U.S. taxpayer, has created vast amounts of purchasing power to buy our exports. It is no coincidence that we still enjoy a most favorable balance of merchandise trade with Western Europe where direct U.S. investment has been most heavily concentrated. A significant portion of overall merchandise exports, up to 25 percent according to some estimates, represents component and other sales to U.S. affiliates

overseas dependent on U.S. capital for their development. We submit that the U.S. export stimulus from foreign investment is significantly greater than any export displacement or substitution effect from locating manufacturing facilities abroad.

Claims that U.S. international companies are "flooding" the U.S. market with cheap products from abroad are wildly exaggerated. In 1968, the last year of record, 92 percent of the merchandise sales of U.S.-owned affiliates were sold in local markets or exported to other countries and only 8 percent were destined for the U.S. Almost half of that 8 percent represented a special situation -- exports to the U.S. from Canadian affiliates manufacturing transportation equipment.

What the critics often fail to realize is that the direct investment approach in many cases is required for doing any business abroad. To quote Mr. John J. Powers, Jr., President of Pfizer Inc.:

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

These are the facts of life for much of international business. Discouraging U.S. investment abroad does not save any U.S. jobs. It does diminish market opportunities and damage our overall international position.

The premise of the foreign investment controls was that the balance-of-payments could be divided up into neat pluses and minuses -- that investment could be held back for strictly short-term gains but that other parts of the international accounts would not be affected. The interrelationships of initial investment, return on investment, exports and other money flows were not considered.

The controls, instituted on a "voluntary" basis in 1966, and on a mandatory basis in 1968, have been in existence for six years. By any reasonable logic this is no "temporary" or short-term period that the framers of the program claimed it could be applied without damage to our long-term balance-of-payments position. While the aggregate volume of investment abroad -- financed by U.S. dollar outflows, retained earnings of U.S. affiliates and local borrowings -- has increased in the interim, it is less than it would have been without the controls. The evidence suggests that our current account, including the merchandise trade balance, has suffered as a result.

Moreover, the controls have forced a huge build-up of costly corporate debt abroad -- over $17 billion -- incurred by both U.S. parent companies and foreign affiliates to finance on-going programs. Interest and principal payments on such debt will be an adverse balance-of-payments factor in the long-run and much more costly in total dollars and in balance-of-payments terms than direct investment outflows.

In response to these problems, the investment controls were liberalized in 1969 and subsequently. However, because of it, major obstacles to the free flow of capital remain and in some cases are becoming more restrictive than before. The program has far outlived whatever usefulness it had, if any, and should be dismantled completely. We urge this Subcommittee to make a strong recommendation to this effect.

Treatment of Foreign Source Income

As opposed to the practice of many other industrialized countries which wholly or partially exempt foreign source income from domestic taxation, the U.S. imposes its corporate income tax on a worldwide basis. Double taxation is avoided through allowance of the foreign tax credit and deferral of U.S. tax until dividend earnings of U.S. affiliates are repatriated. In general principle, this is a reasonable system and for the overall circumstances of international business it has worked perhaps better than would be expected considering the administrative problems involved.

By no means, however, is it a "liberal" system compared to those of our foreign competitors. In addition to the territoriality practice of exempting foreign source income from tax and the granting of various incentives for exports, other countries are far more lenient in their administration of rules on intercompany pricing, which are designed to prevent shifting of income to lower tax jurisdictions. As a result of the 1962 legislation, according to John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, "no other country's administrative enforcement policy even approaches the sophistication or severity of our own." Unfortunately, this policy also has created severe and costly administrative problems for both the taxpayers and the government.

Therefore, considering the balance-of-payments and other benefits that flow from such private investment, it is distressing to hear calls for more restrictive treatment of foreign source income. A commonly-made proposal along these lines is to deny deferral of U.S. income tax on foreign earnings, thus imposing tax before dividends are paid to the parent companies.

This would certainly damage and complicate the U.S. business role internationally, but in all likelihood, it would not result in additional U.S. tax

collected. The effect would be to force U.S. subsidiaries to distribute a much higher proportion of earnings in order to obtain the foreign tax credit. Because U.S. direct investment is concentrated in countries where the combination of the corporate income tax and withholding taxes approximates the impact of our own corporate rate, there is a very minimal U.S. tax collected now on earnings from such investments. The effect of denying deferral would be to raise taxes collected by foreign countries but would not benefit the U.S. Treasury.

A corollary effect would be to force even more overseas borrowing on the part of U.S. affiliates -- with attendant adverse effects on the balance-of-payments in the future -- to replace funds that otherwise would have been reinvested directly to maintain business operations.

Instead of such counterproductive proposals, we urge this Subcommittee to consider several steps that should be taken to ease the tax burdens of U.S. business abroad, with insignificant, if any, cost to the U.S. Treasury.

Many of the most trying and complex tax problems on doing business abroad involve the intercompany pricing rules under Section 482 referred to earlier. We understand that the Treasury currently is studying means of alleviating this situation through new regulations, and we will not comment on it here.

As for the areas where Congress itself must act, there are two major recommendations made and stressed by us and other business organizations in the past. This is by no means an all-inclusive list, and we would be pleased to submit further information on particular points when the Senate Finance Committee becomes more immediately involved.

1. Subpart F

This addition to the Code, as part of the Revenue Act of 1962, is one of the most complex statutes ever enacted. According to best estimates, Subpart F is not productive of significant revenue, and its provisions literally terrify middle and small business enterprise which does not possess the staff or the resources to cope with it. We suggest that serious consideration be given to outright repeal of Subpart F since the reasons for enacting it no longer apply. At minimum, active consideration should be given to repealing or amending its most burdensome and counterproductive provisions, including Sections 954(a), (d) and (e), and Section 956.

2. Section 367

This section was originally enacted for the purpose of preventing tax avoidance in certain exchanges involving foreign corporations and U.S. taxpayers. Its operation is unique in the area of tax administration in that it requires a U.S. taxpayer to establish in advance, to the satisfaction of the Secretary, that tax avoidance is not the principal purpose in certain types of transactions.

We submit that the kind of tax avoidance schemes which the section was originally designed to prevent are effectively controlled under existing case law and by Section 1491 of the Code. We believe that corporations should be permitted to proceed with international acquisitions and reorganizations in the same manner as they do under the general principles of the reorganization sections of the Code. There would still remain the obligation

by taxpayers of establishing, either before the Internal Revenue Service on audit or before the courts, that the transaction involved is not one having tax avoidance as its principal purpose.

Section 367 should be amended so as to remove the requirement for advance approval to avoid the administrative delays involved.

Export Trade and DISC

As indicated, there are many international markets that just cannot be reached without a substantial commitment to direct investment no matter what the policy framework. There are others, however, in which direct exports from the U.S. have played or could play a major role. We still maintain a substantial favorable trade balance in agricultural products and in many technology intensive manufactured products where high levels of U.S. productivity and technology offset lower production costs abroad.

But our export trade faces even more serious tax disadvantages than do American business operations abroad. In addition to the territoriality and relatively lax administrative practices, foreign exporters enjoy a wide range of special incentives, including rate reductions, tax credits, special reserves or deductions and accelerated depreciation for export production assets. Furthermore, under the General Agreement on Tariffs and Trade (GATT), indirect taxes are eliminated from exports and imposed on imports. These indirect taxes include value-added taxes as in France and Germany, turn-over taxes, and the United States' excise taxes. The adjustment for taxes at the border treats all indirect taxes as identical assuming these taxes increase product prices but direct taxes (income, payroll) do not.

These assumptions are not supported by economic evidence. The real effect of indirect taxes on price is controversial but it is clearly not consistent with the maximum allowance given under GATT to countries with high indirect taxation and minimum allowance to those with relatively little indirect taxation, such as the United States. To the extent that direct taxes do raise product prices or indirect taxes do not raise product prices by the full amount of the tax, the present system overcompensates for indirect taxes. The United States, which relies primarily on direct taxes, is thus put at a disadvantage. This is being compounded, of course, by the spread of value-added taxes within the countries of the European Economic Community to replace turn-over taxes of lower rates.

Particularly where there is a reasonably close balance of other factors (production costs, productivity, etc.), our foreign competitors can utilize these tax advantages to shade prices and obtain bigger market shares for their exports. To counteract this situation, many proposals have been made but nothing of substance has been done. The GATT organization has not seen fit to change its rules at all despite U.S. urging. Adoption of a U.S. value-added tax to be imposed on imports and rebated on exports also has been urged, but this would involve substantial questions of domestic tax policy which are not likely to be resolved over the near term.

Last year, however, when the Treasury Department made its proposal for the Domestic International Sales Corporation (DISC) regime, we appeared to be close to at least one answer to our export trade problems. Essentially, the DISC proposal would allow tax treatment of export-related income of a domestic subsidiary similar to that of a foreign affiliate. It would set up a special class of U.S. corporation -- a Domestic International Sales Corporation --

to engage in export sales of U.S. products. Intercorporate pricing arrangements would permit part of the profit on manufacturing and sales to be accumulated in the DISC, and the U.S. tax on the accumulated profits would be deferred so long as such profits are employed in export-related activities. These activities would include loans to the parent company for financing of export facilities including domestic plant and equipment.

This proposal would create a simple and flexible vehicle to encourage thousands of small and middle size U.S. firms to participate in export markets. It would help other firms expand their present export volume by substantial amounts in many cases. Last year, we polled our own International Taxation Subcommittee, consisting of 69 firms with significant interest in international markets, who had carefully analyzed the DISC proposal. Fifty-seven percent of respondents expect that the availability of the DISC tax regime would lead to a substantial or noticeable increase of their own company's exports. Twenty-seven percent felt that DISC would not have a significant impact on their own operations, and 16 percent were unable to assess the impact at that time. Individual members already have submitted material to Congress specifying in detail how the DISC structure would aid and expand their export efforts.

The DISC proposal has several advantageous features which commend it to active consideration by Congress:

1. It fits in well with the rest of the U.S. tax structure. It meets the policy objective of maintaining a consistent framework for international business without impinging on other objectives.

2. Within the market framework, it would have a direct and favorable effect on U.S. employment by encouraging domestic manufacturing operations.

3. The revenue cost to the Treasury would be modest, particularly with phase-in provisions that could apply. Within a relatively short span of years, the incentive effect of DISC on U.S. employment and income probably would result in a net gain to the Treasury.

In sum, this is a practical means of stimulating U.S. exports and U.S. employment in an increasingly competitive world economy.

The NAM was among the first of the business organizations to endorse the DISC proposal. In the year and a half since it was unveiled, it has gathered considerable support among the business community and elsewhere. While it by no means provides a complete foreign trade policy, it serves the public interest and we urge its early enactment by Congress.

NATIONAL COUNCIL OF FARMER COOPERATIVES, 1129 TWENTIETH STREET, N.W., WASHINGTON D.C. 20036,
TELEPHONE (202) 659-1525

Honorable Abraham A. Ribicoff
United States Senate
Washington, D. C. 20510

Dear Senator Ribicoff:

The National Council of Farmer Cooperatives, a nationwide association of farmer-owned, private enterprise businesses engaged in purchasing and marketing of farm supplies and farm products, is vitally concerned with recent developments in international trade matters -- including adverse trends in the U.S. trade balance, widespread drift toward new non-tariff barriers which further restrict U.S. export opportunities or threaten unfair import competition, and other policies or actions by nations of the world which conflict with principles of the General Agreement on Tariffs and Trade or heighten risks of a damaging, perhaps uncontrollable trade war.

Trade is of critical importance to the welfare of our country, as it is to U.S. agriculture. Opportunities for expanded farm export markets are vital to our farmers, our agri-business sector, and our national welfare. We oppose the unilateral establishment of trade barriers which restrict world trade growth, including such insidious non-tariff barriers as variable levy systems and arbitrary or unfair import regulations which seriously disrupt efficient and desirable trade patterns.

The National Council has consistently endorsed the principle of trade liberalization through reduction of trade barriers, by GATT negotiations to the maximum extent possible, to the benefit of all nations through expanded world trade. We support the principle of reciprocity as a basis for negotiating trade barrier reductions, and we favor the extension of Presidential authority for continuing multilateral efforts to expand trade opportunities.

Farm commodities must also be considered as an integral part of the net reciprocal concessions made by all nations in multilateral negotiations. Even though we recognize the strong representations made by U.S. Kennedy Round negotiators on behalf of U.S. farm exports, we deplore the circumstances which limited our agricultural gains to only a small fraction of gains made in industrial sectors.

The strong interest of our membership in expanded trade is reflected in the following National Council policy statement on "Expansion of Foreign Trade in Farm Products":

> "The National Council of Farmer Cooperatives endorses the objectives of expanded world trade and encouragement of market opportunities abroad for American agricultural products. We recognize also that the lowering of barriers which now limit world trade may create serious economic dislocations and that adjustments in trade patterns must normally come about through careful and gradual reduction of trade barriers.
>
> "Under GATT (General Agreement on Tariffs and Trade) or other international trade negotiations, expanded trade to benefit all countries is possible only if offers by all trading partners represent comparable concessions. This principle of economic reciprocity must continue to be the keystone of the U.S. trade agreement policy.
>
> "The National Council recommends renewal of Presidential authority to enter into further trade agreements based on true reciprocity. Many forms of non-tariff barriers, such as quotas, embargoes, unrealistic inspection procedures, and lack of uniformity of grade regulations and tolerances hamper efforts to achieve such reciprocity and severely limit U.S. export opportunities. Negotiations toward trade agreements should be focused on reduction of such non-tariff barriers, and particularly on the variable levy system widely used by the European Economic Community (EEC).
>
> "We are unalterably opposed to the recognition of the variable levy system as a valid policy for trade liberalization, and request that U.S. negotiators press vigorously for its elimination.

"The National Council is concerned over increasing use of international marketing subsidies which are disruptive of long established United States markets. Such practices lead to chaotic marketing patterns which tend to allocate resources on a political rather than a most economic basis.

"We recommend that United States agencies or negotiators involved in such matters view such practices wherever they exist as a serious disruption of attempts to increase world trade on a fair and equitable competitive basis and work to have such practices stopped immediately.

"We favor and urge that if attempts to eliminate such unfair practices are not successful, programs providing funds already available to perishable commodity industries be used (to the extent such funds are available) to meet such unfair trade practices in order to maintain historical marketing opportunities in the markets of the world.

"We also deplore those unilateral increases in tariffs or introduction of other trade barriers which have been made since the termination of the Kennedy Round negotiations. We urge that prompt and positive actions be taken by the U.S. insofar as is practical to offset trade losses and damaging effects to our balance of trade through such unfair practices.

"Trade agreement bargaining which is limited to farm products alone would be ineffective. Farm commodities must be considered an integral part of the broad spectrum of international trade. If we are to grant import concessions on inustrial goods, farm products must be part and parcel of the trade package for which we, in turn, must secure concessions. Any concessions granted by us on industrial and other goods should be accompanied by corresponding reduction of market barriers on commodities for which the U.S. has important historical markets, or by other arrangements which would give satisfactory conditions of access for U.S. farm products.

"Undue protectionism on the part of the EEC will reduce opportunities for world wide relaxing of trade barriers, rational growth of world markets and the consequent economic benefits of specialized production. It will increase the incentives for uneconomic production of many commodities within the Common Market area and will simultaneously exclude competing commodities from the U.S. and other countries.

"We urge that all possible advantage be taken of legislative provisions which may be useful in reducing or withdrawing concessions in order to implement the purpose of expanded trade, where such purpose is being impeded by action not in conformity with the rules of GATT or where there has been arbitrary refusal to fully implement concessions which have been granted to us.

"Before concluding specific trade agreements, full consideration should be given to the possible effects of the extension of the agreement to other countries under the Most Favored Nation Policy."

The National Council favors legislative proposals such as S. 834 which would expand trade and strengthen adjustment assistance provisions for firms and industries which are unfairly damaged by foreign competition. We believe that procedures for relief of U.S. groups damaged by trade agreements or by abrupt or arbitrary trade actions by trading nations are now inadequate. Substitution of the concept of "substantial cause" rather than the "major factor" as a criterion for import injury represents a distinct improvement in this respect.

We also support other amendments or administrative actions designed to streamline procedures for petitioning for relief, hearings, and application of findings.

Removal of the American Selling Price system for applying certain chemical and other tariffs would offer special benefits to U.S. farmers as well as possible speed-up in the schedule for lowering European and Japanese tariff cuts agreed on in the Kennedy Round. Since ASP is seen by many of our trading partners as the epitome of American non-tariff protectionism, its removal would help our negotiators to move more agressively toward reduction of non-tariff barriers on a wide front.

The provisional "ASP package" offers gains for U.S. agriculture through reduced barriers to some U.S. tobacco and fruit exports. Perhaps of greater significance, though, is the opportunity for lowered costs for pesticides, drugs and feed supplements having benzenoid chemical components. A billion dollar farm supply market is involved and substantial reductions in farm costs could be possible if tariff reductions were even partially passed on to farmers.

The National Council is also urgently concerned about the extensive use of non-tariff barriers which threaten many of our export markets for American poultry, grains, fruits, and other farm products. Regrettably, these trade barriers seem to be proliferating since the conclusion of the Kennedy Round, particularly those occasioned by or at least concurrent with further harmonization of the trade and tax policies of the EEC. Major international efforts are needed to measure and agree upon the impact of these barriers on world trade. Before effective progress can be made in reducing these trade impediments, there must be better agreement on the degree of trade restraint imposed by such complex barriers as indirect subsidies, food additive controls, import licensing requirements, and many other damaging or cumbersome procedures, taxes or other trade regulations.

One of the most notorious and damaging barriers to expanded world trade is the variable levy system of the European Economic Community, which we have vigorously opposed as a subversion of the basic principles of the General Agreement on Tariffs and Trade.

We continue our strong opposition to the variable levy. Its damage and its threats are not limited to the harm it does to world wide efforts toward liberalizing trade. It directly and unfairly limits many U.S. farm export markets and establishes a dangerous precedent in the international trade policy arena. It has already done great harm to the American poultry export trade and has hampered U.S. grain export opportunities, in both instances resulting in industry dislocations and uneconomic allocations of European resources which in the long run will likely hurt EEC farmers more than it will help them. It also represents a severe cost burden on European consumers.

Application of the variable levy system as the foundation for a Common Agricultural Policy which would include the United Kingdom as a part of the EC would also represent a staggering further cost for U.S. farmers and a serious blow to the U.S. balance of payments position. As observed in your report of March 4, 1971 to the Senate Finance Committee, "The variable levy system is far worse in its trade effects than import quotas. It is a total negation of any trade competition."

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Export subsidies in various forms have also posed serious recent problems for a number of U.S. farm commodity interests. Established U.S. markets at home and abroad have been threatened by such actions as the Australian subsidy program for canned fruit exports, Israeli citrus subsidies, and European subsidies for certain dairy products, canned ham, and tomato products.

We are greatly concerned also at increasing trade preferences which are in clear violation of the basic spirit, and in some instances of the legal provisions, of the General Agreement of Tariffs and Trade. EEC citrus import preferences are a recent example of restrictive, inward-looking actions which not only damage U.S. farm export markets, but which threaten the entire framework of reciprocity in world trade. EEC tariff reductions on citrus products from Israel, Spain, Morocco and Tunisia which are not extended to other suppliers undercut the credibility of the GATT as an international code of fair trading rules--and in spite of its limitations and its inadequacies, GATT still represents a vital channel for dealing with many crucial problems in world trade.

We believe it is important the EEC be made aware of the broad interest of the U.S. agricultural and trading community in this issue which goes far beyond the extent of damages to the U.S. citrus industry. In a letter of January 26, 1971, sent to key cabinet and other administration officials, (attached for the record), the National Council called for strong efforts by the executive branch to secure favorable response from the EC in returning to the "most favored nation" principle in its import trade. Other farm and non-farm groups have also made similar appeals. We are hopeful this issue can be resolved through negotiations, which are generally preferable to unilateral legislative solutions. We fully support the efforts of the California-Arizona Citrus League in this matter and will continue to support them in their efforts to get a satisfactory response either from the EEC or through GATT.

We wish to express our support for the objectives and the continuation of PL 480, our Food for Peace program. While the primary thrust of this program has been changed from that of "surplus disposal" to encouragement of self-help for economic development, PL 480 remains vital to export markets for such U.S. products as cotton. Furthermore, through the market development activities carried out under this law, broad new commercial markets for U.S. farm products have been opened up.

Our policy on problems relating to excessive imports is set forth in the following current policy statement:

> "The National Council of Farmer Cooperatives recognizes the need for safeguards in any nation's trade policy against excessive imports of commodities already produced domestically in substantial quantities. Such provisions should allow domestic producers of agricultural products to enjoy their fair share of an increasing market at home as well as in world markets.
>
> Provisions of Section 22 of the Agricultural Adjustment Act and of the Trade Expansion Act of 1962 should be promptly invoked when necessary to protect domestic producers or industries against undue import competition. Procedures for adjustment assistance under the provisions of the Trade Expansion Act should be liberalized to provide for more effective and prompt relief. We are greatly concerned over the restrictiveness of interpretation of Congressional intent in this regard, and the negligible benefits which have been available in efforts made to date to obtain such assistance.
>
> United States legislation pertaining to international trade negotiations or arrangements should include:
>
> 1. Reaffirmation of the "peril-point" principle, with such determination to be made by the Tariff Commission, and mandatory requirements that the Executive Branch be accountable to Congress for exceptions made in peril-point proceedings.
>
> 2. Liberalization of "escape clause" provisions of the Trade Expansion Act of 1962, with emphasis on strengthening of procedures for prompt review and action to protect domestic producers and industries against abrupt or critical damage from imports.

3. Specific recognition that the producers of any agricultural product used in the manufacture of a commodity involved in peril-point or escape clause proceedings shall be considered part of the domestic industry producing that commodity, and any organization or group of such producers shall be considered to be interested parties in such proceedings. Adopted 1953. Revised 1969."

In summary, the National Council has consistently endorsed the principle of trade barrier reduction and other measures for expanded world trade. We favor reciprocal actions toward this end, preferably through multilateral negotiations under the General Agreement on Tariffs and Trade. In such negotiations, reciprocity should be considered and applied for all products in international trade, specifically including agricultural items.

We recognize the risks involved in current threats to establish quotas or other arbitrarily imposed barriers, in the U.S. or other countries. We believe that inequitable, arbitrary or unilaterally imposed non-tariff barriers represent the greatest present threat to a continued healthy growth in world trade. We urge all possible efforts through GATT or through other avenues to identify, measure and negotiate for reduction of these barriers.

We particularly object to the use of the variable levy system of trade restrictionism as applied by the European Community in contravention of the trade liberalizing aims of GATT. We express strong opposition, too, to non-tariff protectionist barriers unilaterally applied or increased by some nations since the conclusion of the Kennedy Round, including extreme and unfair export subsidies which have been increasingly used by several countries as basic devices for export expansion.

Particularly as a means of protecting U.S. industry groups against the undue losses or sudden dislocations which may result either from unilateral trade policy actions or in some instances from negotiated trade barrier reduction, we urge that provisions for relief under trade policy legislation be liberalized and streamlined for more prompt and equitable relief. We ask, too, that growers of any agricultural commodity used in the manufacture of a commodity involved in such relief proceedings be recognized as a part of that domestic industry.

We commend you and your Committee for conducting extensive hearings on trade policy matters of crucial importance to U.S. agriculture and to our nation.

We would appreciate the inclusion of this statement as a part of your subcommittee hearings record on current trade issues.

Sincerely yours,

Robert N. Hampton

Robert N. Hampton
Director of Marketing
and International Trade

cc: Members, Senate Finance Committee

NATIONAL COUNCIL OF FARMER COOPERATIVES, 1129 TWENTIETH STREET, N.W., WASHINGTON D.C. 20036,
TELEPHONE (202) 659-1525

January 26, 1971

C
O
P
Y

Honorable Peter M. Flanigan
Assistant to the President
The White House
Washington, D.C. 20500

Dear Mr. Flanigan:

On behalf of U.S. farmer cooperatives and their many farmer members, the National Council wishes to express its grave concern over the unfair and continued discrimination of the European Economic Community against U.S. fresh citrus exports. This action will be severely damaging to our balance of payments position in a $70 million export industry. Of even greater significance, however, it jeopardizes our worldwide credibility in calling for international adherence to the "Most Favored Nation" principle which is the cornerstone of U.S. trade policy and of the code of fair trading rules established through the General Agreement on Tariffs and Trade.

We are deeply concerned that if the EEC can openly and successfully discriminate against citrus, then the world trading community will believe it can also discriminate against any other commodity, agricultural or industrial. It is urgent that the principle of MFN be defended and reestablished, if any meaningful code of fair trading rules such as GATT is to survive as a beacon toward expanded world trade and international harmony. We urge your encouragement of that strong prompt action by the U.S. which is necessary to prevent the erosion of MFN and the crumbling of GATT, in the interest of world trade expansion which will continue to serve the best interests of the U.S. and all nations.

Sincerely,

Kenneth D. Naden

Kenneth D. Naden
Executive Vice President

cc: Honorable William P. Rogers
Honorable Clifford M. Hardin
Honorable Maurice H. Stans
Honorable George P. Schultz
Honorable Paul. W. McCracken
Honorable Carl J. Gilbert
Honorable Henry A. Kissinger
Honorable John B. Connally
Honorable Rogers C. B. Morton

NATIONAL CANNERS ASSOCIATION

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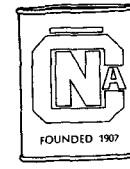

Before the
Subcommittee on International Trade
Senate Committee on Finance
June 15, 1971

STATEMENT OF LEONARD K. LOBRED, DIRECTOR, INTERNATIONAL TRADE DIVISION, NATIONAL CANNERS ASSOCIATION, ON THE NEED FOR MORE EFFECTIVE PURSUIT OF MARKET ACCESS AND EQUALITY OF TRADE OPPORTUNITY FOR UNITED STATES CANNED FOODS

The National Canners Association is supported voluntarily by approximately 600 firms engaged in the production and sale of canned foods. The members of the NCA produce some 90 percent of all canned foods packed in this country, including canned fruits, vegetables, juices, meats, poultry, fish and shellfish, and many formulated canned food products such as soups and baby foods, and other specialties. U. S. exports of canned foods in 1970 totaled $156.1 million, all for cash. The principal export markets are the European Economic Community, which accounts for about one-third of the industry's total exports, the EFTA countries, Canada and Japan.

We respond to the Committee's invitation for submission of written statements with this enumeration of the kinds of trade barriers and trade policy deviations, particularly those of the European Economic Community, which most seriously impede U. S. exports of canned foods, and our stated conclusions that the United States should attend to the rights of market access and equality of trade opportunity to which this country is entitled, and should press more forcefully for faithful adherence to principles of fair play in international economic relations.

We are obliged to emphasize that the effective administration of the trade agreements program depends on forceful and effective pursuit by the Executive Branch of United States trade objectives. We consider that the Executive Branch should pursue more forcefully and more effectively the rights of market access to which U. S. canned foods are entitled.

NTB'S AND TRADE DISCRIMINATIONS, THE CHIEF OBSTACLES TO CANNED FOOD EXPORTS

Although the major items of canned food exports are covered by bound fixed tariffs in the most important markets, market access and equality of trade opportunity for United States canned foods are being curtailed by non-tariff barriers and trade discriminations against the United States.

The most serious export trade problems confronting the United States canning industry at the present time are:

The EEC variable levy on calculated added sugars in canned fruits;

Discriminations in the EEC against canned foods from the United States;

Import quotas in France;

Import quotas in Japan; and

Discriminations in Japan against canned foods from the United States.

Each of these problems has been an obstacle to United States canned foods for a number of years and is well known as such to the Executive Branch. Each is illegal under the GATT or is inconsistent with trade agreement provisions.

At the end of this Statement are descriptions of each of these export trade problems, together with estimates of their dollar impact on U. S. exports.

EEC TRADE ABERRATIONS

Without minimizing the importance of any other trade problems, we focus on the trade aberrations of the EEC, whose member states comprise the largest foreign market for our industry's production.

(1) The EEC Common Agricultural Policy: Excessive import protection and export subsidies

We regard the variable levy as an absolute violation of GATT principles. It is the basis for a complicated regulation under which the EEC assesses a variable levy on the calculated added sugars in canned fruits, varying in ad valorem effect from one shipment to another, in addition to the tariff.

In a public hearing held by the Trade Information Committee on November 12, 1970, the National Canners Association contended that the levy on added sugars is incompatible with the applicable trade agreement provision and is an unjustifiable foreign import restriction within the meaning of Section 252 of the Trade Expansion Act. We asked the Executive Branch to take all appropriate steps to eliminate this EEC restriction, and we believe some progress is being made in that direction.

The variable levy concept is in direct conflict with the GATT in the following respects: It is incompatible with the basic principle of the GATT which calls for import protection exclusively through the customs tariff (Article XI). The variable levy, reference prices, and minimum import prices are even more trade-restrictive than the measures which are expressly prohibited by GATT Article XI. The variable levy is in conflict with the GATT principle that customs valuation be based on actual values rather than fictitious values (Article VII(2)). Contrary to the GATT requirement that import protection should be stable and predictable (Article VII(5)), the amount of the variable levy is subject to change frequently. The regulations are the opposite of the GATT requirement for minimizing the incidence and complexity of import formalities (Article VIII(1)). Moreover, the levels of protection in the variable levy are not negotiable.

The Community itself does not pretend that the variable levy system is legal, but only that it is an adjunct of its Common Agricultural Policy.

The variable levy is infinitely more protective in effect than the ASP and is applied to a value of trade four times the inflated ASP values of U. S. imports subject to the ASP valuation. It is a paradox of trade policy that the United States consented in the Kennedy Round to recommend repeal of the American Selling Price while apparently ignoring that the Community Selling Price--the variable levy--is a much more formidable import barrier.

The variable levy also is the source of funds with which the EEC subsidizes its canned foods in export markets, including the United States, in competition with United States canned foods. Moreover, the levy system is the basis on which the EEC seeks to develop new market regulations, in the form of minimum import prices, on canned fruits, vegetables, and fishery products, that would also be in clear violation of GATT.

(2) Probable Effects of Geographic Enlargement of the EEC Agricultural System

The variable levy system and in fact the EEC's entire agricultural protection and subsidy system are of great potential significance in an enlarged EEC.

Tariffs on canned foods (and other agricultural products) in the United Kingdom, Denmark and Norway are relatively low. Tariffs on the principal U. S. canned food exports are covered by bound fixed tariffs. However, in the event of EEC enlargement the low tariffs on canned foods (and other agricultural products) in the applicant countries will be scrapped, and will be replaced by variable levies and other market regulations under the EEC Common Agricultural Policy.

It is to be expected simultaneously that tariffs on industrial products in the United Kingdom, Denmark and Norway will be reduced to the levels in the EEC. Following are the estimated average tariff levels (based on post-Kennedy

Round tariff rates weighted by 1964 trade) on dutiable industrial products in various countries as reported by the Office of the Special Representative for Trade Negotiations:

United Kingdom . .	10.9%
Norway	10.2%
EEC	8.3%
Denmark	7.9%
United States . .	7.8%

On the basis of the foregoing it is evident that adoption by the applicant countries of the EEC's Common External Tariff will result in lower protection on industrial products entering the United Kingdom and Norway and a slight increase in such protection in Denmark.

However, as import protection on canned foods in each of the applicant countries is a fixed tariff, and at rates generally no higher than 15% compared with EEC protection of 20 to 25% plus the variable levy on calculated added sugars, the adoption of EEC import protection systems will result in significantly increased protection on U. S. canned foods entering the U. K., Denmark, and Norway.

The geographic scope of the objectionable import systems will thus be enlarged from the present six EEC members to apply equally in all applicant countries.

EEC enlargement will lead to a curtailment of U. S. canned food exports as a result not only of more restrictive import barriers in the EEC member states but also as a result of EEC export subsidies favoring exports from the member states to other destinations, outside the EEC. Moreover, with U. K. membership in the EEC its Commonwealth suppliers, such as Australia, will be competing with the United States in all world markets, including even the United States.

It appears that the United States will look after its market access rights in the enlarged Community only following enlargement. It is doubtful

that the United States will receive any tariff benefits other than the reductions in the U. K. and Norwegian tariffs on industrial products. On the basis of our experience in the Kennedy Round, and in recognition of the protectionist character of the EEC's agricultural program, we may expect nothing in the way of improved market access for U. S. agricultural products.

By its failure to safeguard its market access rights during the negotiations, the United States will have sacrificed market access for U. S. canned foods and most other agricultural exports in favor of some reductions in tariff rates on industrial products. American agriculture, which is one segment of the U. S. economy which generally enjoys comparative advantage in the world economy, will have lost much and gained nothing.

There is no way other than a challenge to the EEC agricultural protectionism to avert further serious losses in U. S. agricultural exports.

(3) EEC Discriminatory Trading Arrangements

Another major trade aberration of the EEC is its preferential trade arrangements each of which includes a tariff and trade preference which is discriminatory against the United States.

The EEC is well on the way toward creating a trading orbit which virtually excludes the United States. Preferential arrangements are already in force with 18 West African countries in the Yaoundé Convention, 3 East African countries in the Arusha Agreement, and with Greece, Turkey, Morocco, Tunisia, Spain and Israel, as part of the EEC's Mediterranean Policy. The EEC is discussing preferential trade arrangements with numerous other countries. Following enlargement of the EEC from its present six members to include the United Kingdom, Denmark, Norway and Ireland, the EEC will have created a common market and preferential trading orbit which will embrace most of Europe and Africa.

On the outside of the EEC trading orbit will be only the United States, Central and South America, Japan, and the "White Commonwealth" countries such as Canada, Australia, and New Zealand. Of these, the United States and Japan may be the only truly MFN countries left in the world.

Each of the EEC trade preferences falls short of GATT criteria which provide for common markets or free trade areas within a specified period of time. The United States has challenged the GATT legality of these arrangements, and the Executive Branch is to be commended for its firm stance on this issue. However, it appears that the Executive Branch had better devise a more effective opposition to them, or else a long-range plan which will take account of the United States' eventual isolation outside the EEC trading orbit.

SUMMARY AND CONCLUSIONS

(1) The United States has been too willing to sacrifice its trade interests, particularly its rights of market access for agricultural exports, to the concept of European unification and the needs and desires of other countries. To the extent that the United States receives no reciprocal trade advantages from the EEC's trade aberrations, the citizens of the United States are paying the economic price of European unification and economic development elsewhere.

The United States will pay the price of European unification not only in its diminished agricultural exports to Europe as a result of reduced market access there, but also the United States will become the market outlet for canned foods and other agricultural products from Australia and other Commonwealth suppliers who will simultaneously lose their market access rights in the U. K.

The United States has been too willing in this respect, and should more vigorously defend its rights of market access and its rights of non-discrimination, to which U. S. traders are entitled pursuant to the GATT and trade agreement provisions. It is inconceivable that the GATT should be regarded

as a viable instrument to which the United States should adhere but which other countries will claim only in defense of their rights but not in the exercise of their responsibilities.

(2) The Committee on Finance has inquired whether GATT provisions are adequate with respect to various aspects of trade. The answer seems to depend on whether the GATT is to be respected in principle or only according to the letter. The EEC appears to interpret the GATT to permit any practice that is not expressly forbidden, while most other countries still abide by the GATT as a set of principles for fair play for mutual advantage.

Some have speculated that the GATT is defective in that it was hindsighted but not foresighted, in the failure of its drafters to foresee the development of common markets in their present form and their special needs. To this it can only be said that if all international agreements are to be regarded as satisfactorily hindsighted but lacking in foresight, there would be no point in having any international agreements at all. And the EEC should not be permitted to excuse its own deviations from the GATT on the pretense that it is an imperfect instrument.

All of the EEC's trade aberrations--its Common Agricultural Policy import restrictions and export subsidies, its deviations from the MFN principle, and its complete exploitation of the provisions applicable to direct and indirect taxation--take advantage of the GATT's silence. Yet these trade aberrations appear nonetheless incompatible with GATT principles.

(3) The alternative to principles of fair play in international economic relations would seem to be chaos, and that is almost the state of affairs today as a result of EEC deviations from GATT principles. The United States should press more forcefully--and should use its political as well as economic influence more effectively--for faithful adherence to GATT principles and requirements by

the EEC and other countries which maintain unjustifiable import restrictions on United States canned foods.

The time is long past due for the Executive Branch to attend to the rights of market access and equality of trade opportunity to which the United States is entitled pursuant to the GATT and trade agreement provisions. The United States has adequate authority under existing law to do so. It is hoped that with the establishment of the Council on International Economic Policy the U. S. trade interests will be given more consideration in over-all U. S. policy and programs. The alternative to effective action by the Executive Branch will be the further loss of U. S. agricultural export markets due to the prohibitive import protection and export subsidies of the EEC, its geographic enlargement from the present six to additional countries, and the establishment of an EEC trading orbit founded on trade preferences which discriminate against the United States.

It is a paradox of U. S. trade policy that the Government operates a number of programs designed to promote exports and to exhort businessmen to export, but at the same time does not obtain the market access or equality of treatment to which U. S. canned foods are entitled, for an industry which enjoys comparative advantage and for businessmen who really want to export.

It is hoped that we have thus identified a legislative objective--a clear direction from the Congress to the Executive Branch to utilize its existing authority to pursue United States trade objectives more forcefully.

The Principal NTB's and Trade Discriminations Which Are Obstacles to Exports of U. S. Canned Foods

EEC Variable Levy on Calculated Added Sugars in Canned Fruits: The EEC began on July 1, 1967, to assess a variable levy on calculated added sugars in canned fruits. Operation of the variable levy is technical and complex. Its legal basis is to be found in a provision of the Dillon Round, but the complexity of the levy and its ad valorem effect exceed by far the conditions foreseen at the time of the Dillon Round.

The EEC variable levy on calculated added sugars in canned fruits was assessed during 1969 on a total of 4 million cases of canned fruit from the United States. The variable levy, varying in ad valorem effect from one shipment to another, produces uncertainties for traders and adds approximately 30 cents a case to the landed cost of canned fruits. In order to be competitive in EEC countries with canned fruits produced in the EEC and in African countries enjoying preferential treatment, United States canners are obliged to absorb a portion of the total cost of $1.2 millions of the levy.

The NCA has instituted action within the U. S. Government pursuant to Section 252 of the TEA with regard to this unjustifiable foreign import restriction.

EEC Discriminations against the United States: The EEC has preferential tariff and trade arrangements with African states which are illegal under the GATT.

The EEC has negotiated preferential arrangements with countries in the "Mediterranean Basin" which include preferential tariff arrangements discriminating against United States canned foods, especially citrus products, in violation of the most-favored-nation principle.

France: Import Quotas: France continues to restrict imports of United States canned fruits by means of an import quota system which has been declared by the GATT to be illegal under GATT Article XXIII. The quota allowances are inadequate, and France is dilatory in issuing import licenses, often reneging completely on issuance of licenses to importers.

Per capita consumption of canned cling peaches in France is estimated at 4.2 pounds annually, compared with 10.3 pounds in Benelux and 10.7 pounds in Germany. Assuming that per capita consumption of canned cling peaches in France, in the absence of import quotas, would be half as much as the per capita consumption in the neighboring countries of Germany and Benelux, United States exports of canned peaches to France could be increased by one million cases, having a value of $5 millions.

Per capita consumption of canned pineapple in France is estimated at less than one pound annually, compared with 2.0 pounds in Germany and 2.3 pounds in the United Kingdom. Assuming that per capita consumption of canned pineapple in France, in the absence of import quotas, could be increased by only one-half pound annually, United States exports of canned pineapple to France could be increased by 500,000 cases, having a value of $2.5 millions.

Other canned fruits under import quota include fruit cocktail and cherries.

Japan: Import Quotas: Japan continues to restrict imports of a number of United States canned foods, of which tomato products appear to have the greatest export potential, by means of import quotas.

Japan: Discrimination against the United States: In 1968 approximately 1.75 million cases of canned pineapple from the Ryukyus, entering duty free and quota free, provided 70 percent of Japan's imported canned pineapple. The remaining 30 percent was entered under the global quota. Taiwan dominates the global quota by maintaining a 482,000 case level it had acquired under a bilateral agreement with Japan prior to the quotas. This 482,000 case level represents 64 percent of the global import.

In addition to the restrictive quota, Japan assesses an ad valorem duty of 55 percent on canned pineapple imports except from the Ryukyus. Per capita consumption of canned pineapple in Japan is estimated at 1.1 pound, compared with 2.0 pounds in Germany, 2.3 pounds in the United Kingdom, 2.3 pounds in Canada, and 3.1 pounds in the United States. Assuming that per capita consumption of canned pineapple in Japan could be increased to one-half the per capita consumption in the United States, United States exports of canned pineapple could be increased by one million cases, having a value of $5 millions.

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BRANCH OFFICES { WARSAW – BUCHAREST – BUDAPEST
PRAGUE – SOFIA – MOSCOW

TELEX 422149 CRIM UI

Soviet Import Export, Inc.

121 EAST 31ST STREET
NEW YORK, N. Y. 10016
(212) 686-7590

June 4, 1971

Russell Long, Chairman
United States Senate
Committee on Finance
Washington, D.C. 20510

Dear Senator Long:

In reference to your letter of May 26th, regarding the Subcommittee on International Trade, which includes testimony on East-West trade.

Per your suggestion, we would like to submit a statement, for the record, on East-West trade and would appreciate if you would send us a copy of the record.

Soviet Import Export, Inc., a New York corporation, is involved in the trade between the East and the West. I travel very extensively in Eastern Europe, which includes the countries of East Germany, Poland, Russia, Romania, Hungary, Czechoslovakia, Bolgeria and Yugoslavia, and have offices and personnel located in Warsaw, Bucharest, Budapest, Moscow, Prague, Sofia, and Belgrade.

Soviet Import Export, Inc., represents over 75 of the largest American corporations in Eastern Europe on their products. In addition, we also represent exclusively, several of the State Trading organizations of Eastern Europe on the sale of their products in the United States.

The United States is losing the race in sales to Eastern Europe on products, equipment and technology to Western Europe and Japan, because of several factors, and I list the following reasons:

1. At one time, the United States enjoyed the reputation of having proprietory equipment, products and technology, far superior to Western Europe and Japan. But, because of cross-licensing and off-shore facilities, our Allies have now gained the knowledge where they are equal in quality and proprietory on equipment and technology, and in some cases are superior.

   Last year reports published, that there was 20 billion dollars worth of products, equipment and technology sold to Eastern Europe total, of which our Allies did approximately $19,500,000,000.00, and the United States did $500,000,000.00.

   As you know, there is an international organization called CO-COM, located in Paris, which has the right to approve, and disapprove any Export Application from our Allies on products sold into Eastern Europe, and of course, the United States has the same right to object. Yet, there has been millions of dollars worth of Export Applications which has received denial, because our Inter-Agencies disapproval. From my understanding, the Department of Defense, their objections generally state that it is to the best interest of the United States to deny the Application. I would agree with the Department of Defense, if we were the sole manufacturer, and had the sole proprietory rights and technology, to deny the Applications to Eastern Europe. However, as I mentioned earlier in this statement, our Allies have this technology and we have passed and approved their Applications at CO-COM. To give you some examples; it is a known fact that Russia is building the I.B.M. 360/40 Computers. It is a known fact that England is selling 4th Generation Computers to Eastern Europe, yet if there is an Application placed for 3rd Generation Computers for U.S.S.R., these Applications are denied, on the basis that it is detrimental to the best interests of the United States.

   Gleason Industries out of Rochester, New York, had an Application since 1969 for $9,000,000.00 worth of tools and machines. It has just been announced that the

Department of Commerce has granted an approval. Certainly, Eastern European countries are not interested in prolonged deliveries or indecisions.

I have found, in my travels, and in my constant discussions with my representatives, that the buyers of the State Trading organizations and their customers will only buy from the United States, if they feel that the quality of the product is better than the quality that they are getting from their present source of supply. But, this is becoming less and less, as the quality of Western Europe and Japan is improving.

We must have a better relationship in the Applications being submitted for Export Licenses, with the Department of Commerce, with quicker decisions than we have had in the past. Because, if we don't, you will find that we will be receiving very little proposals in the future to supply equipment and products to Eastern Europe.

2. Western Europe and Japan has worked arrangements with their national banks for long-term financing on various projects for Eastern Europe. As you know, Export-Import Bank has no jurisiction in approving any loans to Eastern Europe. I have worked out arrangements, with private banking throughout the world, to extend seven(7) years credit to Eastern Europe, only because of the fact that the principles whom I represent, whose annual sales exceeds 6 billion dollars, are willing to cooperate with the banking institutions, in the guarantying and warantying of their products and equipment. We should have Legislation to permit Export-Import Bank to extend credit to Eastern Europe as we do the rest of the world.

3. Our Government should do what the Heads of the Governments of France, England, Germany, Italy, etc. is doing, in sending their leaders to Eastern Europe to promote trade relations. I am positive that we can obtain a tremendous percentage of the existing trade going into Eastern Europe, providing our Government will cooperate with the United States manufacturers and exporters. I am willing to give my time and assistance to your Committee, at your request.

Trusting that this information will help you formalize opinions, which will be benefical to the Trade between the United States and Eastern Europe.

Respectfully yours,

Robert Ross

RR/gg

International Union *of* Electrical, Radio and Machine Workers

Affiliated with the American Federation of Labor and the Congress of Industrial Organizations, CLC

1126 16TH STREET, N. W. WASHINGTON, D. C. 20036

PAUL JENNINGS, *President*
IRVING ABRAMSON, *General Counsel*

Phone: 296-1200

June 3, 1971

The Honorable Russell B. Long
Chairman, Senate Finance Committee
United States Senate
2227 New Senate Office Building
Washington, D. C. 20510

Dear Senator Long:

This International Union, like others, has in recent years become vitally concerned with foreign trade problems. Our members have been so severely affected by the flooding into this country of electronics imports that we have been required to reconsider the basic tenets of this country's trade policies. We have concluded that the only solution which can effectively deal with the problem itself is legislation to regulate the level of imports. Consequently, we strongly favor the AFL-CIO position on necessary foreign trade legislation. This letter is concerned with the much more narrow issue of meaningful enforcement of existing law. Until the policies embodied in the Trade Expansion Act of 1962 are modified, our experience leads us to suggest that appointments to the U. S. Tariff Commission should be examined to see if nominees are willing to enforce the existing legislation.

Our concern with the impact of imports has caused us to, among other things, initiate or participate in various types of proceedings before the U. S. Tariff Commission including worker adjustment assistance cases, escape clause proceedings and dumping investigations. We have learned that a majority of the sitting Tariff Commissioners has fixed views that, in effect, preclude granting any relief under the Trade Expansion Act of 1962. Such interpretations of the law are not required, as

shown by the views of other Commissioners, and appear to result from hostility toward even the limited purposes of the law. We believe that appointments to the Tariff Commission should be examined by your Committee to determine whether their views of the law and relevant social policies would permit them to administer the laws in accordance with the intent of Congress.

I am enclosing for your information a memorandum which sets forth several areas as to which we believe that a nominee to the Tariff Commission could be questioned in the course of his confirmation hearing. Such questionning by your Committee would be of great assistance to us in determining the qualifications of the nominees. Of course, we further believe, and will urge when appropriate, that responses by a nominee which do not clearly demonstrate a willingness to afford relief to workers and industries adversely affected by imports disqualify such a nominee from holding a position as a Tariff Commissioner.

Very truly yours,

Paul Jennings
President

mhl

Enclosure

INTERNATIONAL UNION OF ELECTRICAL, RADIO AND MACHINE WORKERS, AFL-CIO-CLC

LEGAL DEPARTMENT

Date: June 3, 1971

To : Paul Jennings, President

From : Richard Scupi, Assistant General Counsel

Subject : Restrictive Views Of U. S. Tariff Commissioners As Reason For Denials Of Relief Under Trade Expansion Act Of 1962.

The availability of relief under Section 301 of the Trade Expansion Act of 1962 (TEA) to workers, firms and industries adversely affected by imports largely depends upon the attitudes of individual Tariff Commissioners toward the desirability of such relief. From 1962 until mid-1969 it appeared that the requirements of the TEA were so restrictive that relief was simply not available, either of the adjustment assistance type or of the import restrictions type in industry "escape clause" cases. This view developed because of the following record established by the Tariff Commission in applying the TEA from 1962 until mid-1969.

Type of Case	Commission Determination		
	Affirmative	Negative	Equally Divided
Worker	0	6	0
Firm	0	7	0
Industry	0	13	0

Given this record, it was not unnatural that the reasons stated by the Tariff Commission for its negative determinations came to be accepted as the necessary applications of the language of the TEA.

The administration of the TEA by the Tariff Commission from mid-1969 to date demonstrates that the restrictive views of the law previously established were not the only ones possible. With no changes in the statutory language having a bearing on Commission determinations, the following record of decisions was made from mid-1969 until June 1, 1971.

Type of Case	Commission Determination		
	Affirmative	Negative	Equally Divided
Worker	12	40 plus 4 partial cases	23 plus 4 partial cases
Firm	1	6	7
Industry	1 partial case	2 plus 3 partial cases	1 plus 2 partial cases

The 14% record of affirmative rulings, added to the 32% record of equally divided votes, meant that from a seven-year record of denying all relief the Commission moved to a record of providing

relief in almost one-half of the cases. Naturally the number of cases skyrocketed as soon as it was learned that relief <u>might</u> be available.

When the mechanics of the Commission's processes are examined, the most striking fact is that the equally divided cases generally involved the same split of individual Commissioners voting affirmatively and negatively. Those voting negatively repeated and relied upon the reasoning of the Commission during the 1962-1969 period; the Commissioners voting for relief introduced new meanings to the statutory language that permitted them to apply the TEA in an entirely new way. No longer is it possible to view negative determinations of the Tariff Commission that affect our members as natural results of an overly restrictive law. The fact is that negative determinations in almost every instance result from Tariff Commissioners who prefer to apply the law in a restrictive fashion. Whether this is the result of the social views or conditioning of individual Tariff Commissioners or whether it is the result of indolence which permits the views of the Commission staff to determine the casting of votes is of no significance to us. What does matter is that right now Tariff Commissioners can vote for relief under persuasive

and sound constructions of the Act. Unfortunately, most Commissioners still prefer to vote negatively. Indeed, the current make-up of the Commission again has a clear majority of Commissioners who have established their restrictive views of the TEA. Unless new appointments to the Commission will exert themselves to apply the law to provide meaningful relief, the 1962-1969 record of the Commission may be the pattern for its record in the immediate future.

The TEA provides that relief to workers, firms and industries is available where, among other things, it is found by the Tariff Commission that increased imports are "a result in major part of concessions granted under trade agreements...." The law here clearly requires a finding of some type of causal link between trade agreement concessions and increased imports. The degree of this required causal link required by a Tariff Commissioner is more than any other factor the touchstone as to whether he will generally vote for or against relief. Congress made it clear that <u>all</u> trade agreement concessions were to be considered in the aggregate in determining whether the

required[1/] causal link between concessions and increased imports was present. Nevertheless, certain Commissioners have over the years established a gloss on the statutory language that, in effect, precludes consideration of any tariff reductions which preceded the relevant increase in imports by more than a year or two.

In a firm case involving high fidelity stereo and related equipment,[2/] where the Commission equally divided, the Commissioners voting negatively stated:

> "The facts do not show that the increased imports are in major part the result of concessions granted under trade agreements. The largest reductions in the rates of duty applicable to the types of high-fidelity stereo and related equipment produced by the petitioning firm took place, in the main, in years prior to, and including 1951. For example, the rate

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1/ Both the House and Senate Committee reports on the TEA explain the language as follows:

> "The phrase 'as a result of concessions granted under trade agreements,' as applied to concessions involving reductions in duty, means the aggregate reduction which has been arrived at by means of a trade agreement or trade agreements (whether entered into under Sec. 201 of this bill or under Sec. 350 of the Tariff Act of 1930." H.R. Rep. No. 1818, 87th Cong., 2d Sess. 46 (1962); S. Rep. No. 2059, 87th Cong., 2d Sess. 20 (1962).

2/ H. H. Scott, Inc., Maynard, Mass., Inv. TEA-F-13 (January 1971), TC Pub. No. 355, pp. 3-4.

of duty applicable to solid-state radio receivers and tuners, which accounted for most of the imports during the period from January 1965 to June 1970, was reduced by trade agreements from the 1930 statutory rate of 35 percent ad valorem to 15 percent ad valorem in 1948, and to 12.5 percent ad valorem in 1951. Subsequent reductions of 0.5 percent ad valorem occurred in 1968, 1969, and 1970. In 1970 the rate for such receivers was 11 percent ad valorem. Imports of such high-fidelity equipment, the great bulk of which was from Japan, were not a significant factor until the mid-1960's. The rapid increase in imports from Japan during the period 1965-1969 and January-June 1970 as shown in the factual section of this report could not have been caused by the duty reductions that occurred almost two decades earlier."

The Commissioners voting for relief reached the opposite conclusion:[3/]

"Before a petitioner can be found eligible to apply for adjustment assistance, the Commission must find that the increased imports resulted in major part from trade-agreement concessions. This requirement is met if, but for concessions, imports would not be at substantially their present levels."

* * *

"It is not possible to make a precise determination of what effect these reductions in duty had on the competition between domestic and imported hi-fi equipment, because the models of one company are not exactly the same as the models produced by its competitors, both foreign and

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3/ Ibid., pp. 7-9

> domestic. Information obtained by the Commission indicates, however, that in general the imported products appear to sell at prices about 20 percent lower than the most similar domestic product. This price differential is almost exactly the amount by which the duty has been reduced, indicating that if the concessions had not been made, the imported product would be selling in the same general price range as the domestic product."
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> * * *
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> "Accordingly, we conclude that, but for the concessions, imports would not be at substantially their present levels, and that, therefore, they have increased in major part as a result of concessions within the meaning of the Act."

This same difference in approach by the individual Commissioners is found in case after case. This is particularly so in electronics industries cases where the patterns of tariff reductions and increased imports are similar if not identical. Thus, the optimum result in electronics industries cases in 1970-1971 has been an equally divided Commission, with the same line-up of Commissioners voting affirmatively and negatively.

The view that only quite recent tariff concessions could cause an increase in imports has been justified on the following grounds of theory and legislative intent.

"Normally, the maximum stimulation to imports as a result of trade concessions would be expected soon after the concessions were negotiated. Even after making allowance for the World War II dislocation to foreign industry and other time lags needed to take advantage of the concession in question, it is clear that the rate reduction on this class of merchandise was made so long ago as to preclude its being the major factor in the surge of imports that occurred from 1964 to 1967."4/

"Trade-agreement concessions need not be the sole cause of the increased imports. But the increased imports must result in major part from the concessions. The duty reductions must be an important consideration -- as important as or more important than other considerations -- in bringing about the increase in imports. While it is true the text and the legislative history of the Trade Expansion Act of 1962 indicate that all trade-agreement concessions are to be considered in the aggregate, Congress in enacting this form of relief for domestic industry was especially concerned with the future trade agreement concessions to follow the enactment. Thus, concessions of recent vintage, i.e., those granted under the Trade Expansion Act of 1962, require especially close scrutiny in any determination under Section 301 of the TEA." 5/

In cases initiated by us involving television receiver plants that closed down, one Commissioner relied entirely

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4/ Nonrubber Footwear, Inv. TEA-I-18 (January 1971), TC Pub. 359, p. 39. In Softwood Lumber, Inv. TEA-I-4 (February 1963), TC Pub. 79, we find it said that "The Commission observes further that maximum stimulation of imports attributable to a reduction in duty generally occurs directly or shortly after the reduced rates come into effect." (p. 10)

5/ Pianos and Parts Thereof, Inv. TEA-I-14 (December 1969), TC Pub. 309, p. 10.

upon the ground that the tariff reductions largely antedated the increased imports by many years in voting negatively.[6/] We included a critique of this view of the Act in our recently filed case seeking import restrictions for the television receiver industry, which states in part:

> "The 'time lag' basis for negative finding here rests, as has been mentioned, upon a gloss of the statutory language to limit relief to immediate effects of tariff reductions. Apart from this, in our view, dubious statutory gloss, the time lag argument is not applicable to the facts of this proceeding. When the first 10% of the tariff reduction took place in 1939, household television receivers were not an article of domestic trade; the required technology had not yet been developed. Under such circumstances, the failure of imports to increase soon after 1939 is totally explained by the lack of any trade in television sets. No inference can possibly be drawn that the duty reduction did not engender increased imports because the market was not sensitive to duty reductions, for no market existed. Any market reaction to the tariff reduction would have to wait until the market came into existence. To discount the influence of the 1939 tariff reduction on subsequent increased imports because imports did not increase immediately after the tariff reduction would be like discounting the influence of environmental factors on an infant because the factors had existed for 10 years before the infant's birth without any effects on the infant."

6/ Television Receivers: Production And Maintenance Workers At RCA Corp. Plant, Memphis, Tenn., Inv. TEA-W-70 (April 1971), TC Pub. 376, p. 9; Television Receivers, Radio And Phonographs: Former Workers At The Emerson Television And Radio Company, Jersey City, New Jersey, Inv. TEA-W-77 (April 1971), TC Pub. 380, p. 8.

It can thus be seen that the approach to the TEA taken by certain Tariff Commissioners makes it impossible for them to reach an affirmative result in virtually all cases involving any part of the electronics industry. Even though it is clear that imports could not have risen as they have if the tariffs were at the 1930 rate, and that this finding satisfies the statutorily required causal link between tariff concessions and increased imports, the TEA has been interpreted so as to avoid an affirmative finding. The domination of the Tariff Commission by Commissioners hostile to the purposes of the TEA certainly requires that, among other things, every effort be made to secure the appointment of Commissioners willing to apply the Act so as to provide relief.

Our experiences with the Tariff Commission to date have primarily been based on the worker cases we have initiated seeking adjustment assistance for our members. These worker cases, and firm cases as well, provide relief in the form of adjustment assistance. This relief, of course, treats the symptoms of the imports problem in the electronics industry. The TEA also provides for industry-wide proceedings; the relief here, however, goes to the cause of the problem. When the statutory criteria

in an industry case are met, Section 301(e) of the Act states that the Tariff Commission is to determine:

> "the amount of the increase in, or imposition of, any duty or other import restriction on such article which is necessary to prevent or remedy such injury...."

While the Tariff Commission has hardly established a record of being sympathetic to adjustment assistance claims, the record in industry cases, where import restrictions are a mandatory feature of the Commission's recommended remedy, makes the adjustment assistance record look good by comparison. In 18 industry cases, there have been 14 totally negative determinations plus 4 cases where part of an industry received either an affirmative (1) or equally divided vote (3).

In at least three of the industry cases where a totally negative result was not reached, the Commission was still unwilling to provide the remedy mandated by the law.[10/] In the

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10/ The fourth case was something of a sport where a single Japanese producer had monopoly power in both the Japanese and U. S. markets, acting here through a subsidiary. Import restrictions thus could aid U. S. industry only if the Japanese-owned U. S. firm was a U. S. industry. It is difficult to see how the policies of the TEA can be brought to bear in such an unusual situation. Barbers' Chairs, TEA-I-16 (April 1970), TC Pub. 319.

first case where the Commission voted 3-2 for relief for part of an industry, 2 of the 3 Commissioners voting affirmatively refused to provide any import restriction whatsoever but simply found that future scheduled tariff reductions should be delayed.[11/] The other Commissioner voting affirmatively found that a rollback of tariff reductions was necessary.[12/] He did not point out the obvious inconsistency in his colleagues' finding "serious injury" to the industry from imports within the current tariff structure and then not finding that any relief was necessary to "prevent or remedy such injury" as required by the Act. In another industry decision which issued in January 1971 where the Commission was equally divided, the Commissioners voting affirmatively found that restoring the 1969 tariff levels would be an adequate remedy.[13/] One of the Commissioners voting negatively made the obvious point that "the slight rate increase which they find as being necessary to prevent serious injury could and would not provide effective relief to domestic injury."[14/] That the unwillingness of the

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11/ Pianos And Parts Thereof, Inv. TEA-I-14, TC Pub. 309 (December 1969), p. 8.

12/ Ibid., at p. 16.

13/ Nonrubber Footwear, Inv. TEA-I-18 (January 1971), TC Pub. 359, p. 24a.

14/ Ibid., at p. 30.

Tariff Commission to provide the remedy spelled out in the law in industry cases arises from the application of the law according to the policy views of the Commissioners is clearest in the last of these 4 industry cases. There two of the three Commissioners voting affirmatively recommended that the tariff be raised to the 1930 statutoty rate.[15/] The third of the affirmative-voting Commissioners proceeded to find that adjustment assistance was the desirable remedy even though he conceded "the Act requires the Commission to determine the level of import restrictions which would be necessary to remedy the injury."[16/] Consequently, while half of the Commissioners voted affirmatively, less than half followed the statute in finding the necessary import restriction to remedy the serious injury to the industry.

Congress obviously intended to enact legislation that had some meaning when it provided for industry relief from imports by imposition of import restrictions. The law has had no meaning whatsoever because of an unwillingness to enforce it. This utter lack of significance of industry "escape clause" provisions in

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15/ Flat Glass And Tempered Glass, Inv. TEA-I-15 (December 1969), TC Pub. 310, p. 18.

16/ Ibid., at p. 30.

the TEA is, of course, a major reason for the refusal by concerned unions to take seriously suggestions for modifying the statutory language. If there is no enforcement of the law, it does not matter what the language of the law happens to provide. Indeed, if existing law were enforced, large segments of the electronics industry that have been and are being devastated by imports would be eligible for import restrictions under the terms of the TEA. Our pending case seeking import restrictions for the television receiver industry will demonstrate the point that where there is an unwillingness to enforce the law, reasons can be found to justify that result.

In sum then, the following issues could serve to indicate the readiness of an individual to provide relief as a Tariff Commissioner under the TEA. The inquiries are phrased so that affirmative responses indicate a willingness to provide the relief spelled out in the TEA in appropriate cases.

1. Whether all tariff reductions from the statutory rate are to be considered in the aggregate, and not singly, in determining whether increased imports are the result, in major part, of trade agreement concessions.

2. Whether a finding that absent the aggregate tariff reductions imports would be at their present levels satisfies the required statutory causal link between tariff concessions and increased imports.

3. Whether the passage of twenty or more years from the time of the most substantial tariff reductions on an article until imports of that article increase does not show that the required statutory causal link between the two events is absent when imports would not have increased to their present levels if the tariff rate had not been reduced in earlier years.

4. Whether the Congress in enacting the TEA of 1962 was equally concerned with the effects of all tariff reductions and not primarily with the effects of post-1962 tariff reductions.

5. Whether the import restrictions relief in industry cases provided by the law is a remedy that should be made available whenever a fair reading of the law's requirements calls for that remedy regardless of any views as to the overriding importance of unrestricted foreign trade.

6. Whether the desirability of import restrictions in

any case is a matter that the Tariff Commissioner should not consider.

7. Whether the existence of substantial reasons for an increase in imports other than a reduced tariff rate has no bearing on finding the required statutory link between tariff concessions and increased imports when it appears that imports would not be at their present levels if the tariff rate had not been reduced.

8. Whether the required statutoty link between increased imports and unemployment (in a worker case) or serious injury (in a firm or industry case) is present whenever the unemployment or serious injury would probably not have resulted absent import penetration of the U. S. market.

RUSSIAN DOLLAR BONDHOLDERS COMMITTEE OF THE U.S.A.
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29 May 1971

Honorable Abraham A. Ribicoff, Chairman
Sub-Committee on International Trade of the Senate Finance Committee
United States Senate
Washington, D. C. 20510

Dear Senator:

Inasmuch as the staff of the Sub-Committee on International Trade was unable to invite our Chairman, Professor Hubert Park Beck to testify personally before your fine Sub-Committee, your Mr. John A. Koskinen kindly suggested to us that we send to you the enclosed statement by Dr. Beck regarding the point of view of several thousand United States citizens living in more than thirty states of the Union and abroad who are owners of Russian Government Dollar Bonds.

A basic ingredient of international law is the accepted fact that a successor government that takes over all the assets of a prior government, must also assume the legitimate liabilities of that prior government. It is because the present Russian government has ---in the case of the Russian Dollar Bonds--- disregarded this basic international law, that this statement is being made.

As Dr. Beck's statement indicates, Russian Dollar Bondholders agree with Mr. Eugene R. Black (past President of the World Bank) who, in 1965 said ..."reasonable settlements of these claims (of U. S. nationals against the USSR) should be obtained prior to extension of any Government-guaranteed commercial credit."

Our Russian Dollar Bondholders will appreciate it very much if your Committee considers Dr. Beck's statement and includes it in the official record. Thank you.

Cordially,

Nelson Bengston

Nelson Bengston
Secretary

A SUCCESSOR GOVERNMENT IS RESPONSIBLE FOR THE LEGITIMATE DEBTS OF ITS PREDECESSOR.

Statement of Dr. Hubert Park Beck, Chairman of the Russian Dollar Bondholders Committee of the U. S. A., and Professor, The City College of the City University of New York.

INTERNATIONAL TRADE AND THE SETTLING OF DEFAULTED GOVERNMENT DEBTS

Progress currently being made to improve relations between the United States of America and the U. S. S. R., and between the U. S. A. and the People's Republic of China, has won widespread approval. Hopes are now growing that the relations between our country and these other two important powers will rapidly approach normal, opening the way for more exchange of visitors, scientists, businessmen, publications and trade.

One serious impediment to good relations between nations is the existence of defaulted debts. Nations now in serious default on publicly-held dollar bonds are the U.S.S.R., Poland, Rumania, Hungary, Bulgaria, Czechoslovakia, East Germany, Cuba and the People's Republic of China. Similar defaults that existed earlier have been corrected in substantial numbers. During the past twenty years such defaults have been cured by Bolivia, Yugoslavia, Greece, Saarbruecken, Austria, the Federal Republic of Germany, Ecuador, Costa Rica, Japan and Peru. An important result, of course, has been improved relations and more trade with those countries.

In the early 1930's, during a period of improving relations between the U. S. A. AND THE U. S. S. R., there were discussions of the Russian dollar debts. At times, prior to recognition of the U.S.S.R. by Washington, hopes rose that a debt settlement would be attained. Those hopes were not fulfilled.

Now again the relations between these two important nations are improving, and hopes of a debt settlement are again rising. Consequently, it is appropriate that the situation be freshly reviewed, and that negotiations be taken up once more. Such is the request of the Russian Dollar Bondholders Committee of the U.S.A., of which I am Chairman.

In his important book, The Roosevelt-Litvinov Agreements, Professor Donald G. Bishop states,"One of the most acute problems between the two governments was that of the Soviet Government debts. This held widespread interest in the United States because it involved the government itself, a number of American corporations and their stockholders, and a considerable number of private American citizens, all of whom had suffered losses through the conduct of the Soviet government. The problem... involved the American belief in the sanctity of private property. Few Americans knew much in 1933 about the history of the Soviet system, but its violation of private property was known to more people than any of its other activities." (p. 140)

Your Committee will perform a great service for peace and amity and world trade if it will help to facilitate the settling of this debt. Therefore, I suggest that your Committee should clearly recommend that neither long-term credits, nor loans, nor payment guarantees should be permitted American nationals or corporations in their dealings with any nation while that nation is in default on its publicly-issued dollar bonds. Short-term credits should be limited to brief periods and to modest amounts. Rollover should be forbidden.

Renewed efforts should be undertaken with a view to reaching bilateral agreements with defaulting nations to resume debt service and to repay loans. In order to spur the Department of State to strive toward this end, my Committee recommends that the Congress require annual public reports from the Department of State as to the status of defaulted dollar bonds. Such reports would be most practical and useful if made a part of the annual report now required by the Congress concerning outstanding foreign loans and other credits from United States Government Agencies. By requiring such annual reports of defaulted dollar bonds, with accompanying information as to efforts made to achieve settlements during the preceding twelve months, the Congress can systematically review what progress has been made in this important area of international relationships.

By not following in some such manner the course of defaulted foreign debts, the Congress lend credence to the belief that it is not interested in the plight of American nationals who are at the mercy of the defaulting nation. They cannot sue in any court. Too many people

in foreign lands already view America as a nation that hands out loans freely, and then is not much concerned whether the loans are ever repaid.

I close by reminding your Committee of the importance of its acting to undergird the integrity of private property and the importance of payment of international debts. What will be the outcome finally if nations are permitted without hindrance to i gnore their defaults in debts to the United States of America?

Foreign Investment and the Multinational Corporation

A. T. Knoppers

Senior Vice President

Merck & Co., Inc.

Subcommittee on Foreign Economic Policy
May 19, 1970

Mr. Chairman,

Thank you for this opportunity to share some personal observations with your Committee.

As part of its study of a foreign economic policy for the 1970's, the Committee is seeking in this particular set of hearings to re-examine U. S. policies to assist the developing nations. Clearly the multinational corporation can be a key factor in providing such assistance. The activities of such corporations, as they relate both to their headquarters countries and to the developing nations in which they do business, present subtle and sophisticated problems requiring thoughtful and patient examination if their force and influence are to be seen in proper perspective. I am sure the business community would applaud the approach this Committee is taking in developing information that can be brought to bear on national policy.

Let me congratulate you particularly on the quality and diversity of the witnesses you have gathered for this phase of your inquiry. Many have made major contributions to a better understanding of the economic problems that confront us now and will confront us in the years ahead. My role is to speak as someone who has been involved in the give-and-take of multinational business for a number of years, and who necessarily draws conclusions primarily on the basis of this experience.

The Committee has undertaken a constructive task in this effort to gain new insights into how business and all other complex factors of the international economy interact. I hope that my remarks on the multinational corporation and the considerations that determine its investments in developing nations may open avenues for discussion and exploration for you.

The multinational corporation, as I see it, has something in common with happiness or misery: no one can quite define it, but you always know when it is there. I think it is enough of a definition to say that the multinational corporation is a business organization that sees the world -- or a goodly portion of it -- as its market, and acts to make the most of its opportunities on a supranational basis.

By this definition or any other, most multinational corporations -- or to use the more accurate term, multinational enterprises -- are United States-based. This, of itself, puts certain constraints upon their operations and complicates decision making, when compared with the relatively greater freedom of some of their Europe-based counterparts. Christopher Layton has observed that of the five hundred largest corporations in the world, three hundred and six have headquarters in this country. Accumulated private direct foreign investment by U. S. industry is estimated at $65 billion.

Thirty per cent of our investment abroad, however, is in Europe. The total long-term European investment in the United States, currently about $26 billion -- largely portfolio investment -- just about evens out with U. S. investment there, the latter being largely direct investment. When we remember that Europe is coming on rapidly in developing its economic muscle, U.S. investment in Europe does not pose a threat. When we

look to the developing world -- and here we are talking about two-thirds of the world -- we find quite a different picture.

The Pearson commission, working with 1968 statistics, found that direct industrial investments that year by developed nations in the developing countries were only $2.7 billion. Although the statistics are not completely compatible, compare this with U. S. industry's direct investment of $2.5 billion for France alone in the year 1965. Of the total cumulative industrial investment in developing countries of $30 billion, virtually half was in petroleum, mining, or smelting, with only a little over a quarter in manufacturing.

While all companies have a goal of making a profit, there are as many kinds of multinational corporations as there are motivations for going abroad. Extractive industry goes abroad because that is where mineral sources lie. Other companies simply go abroad to find new markets.

It is edifying and hopefully chastening, in view of the intense poverty that haunts most of the world, to reflect on just how great our good fortune is in the United States. Robert Heilbroner has pointed out that even after it has paid for research and development, paid its taxes and distributed dividends, the U. S. industrial complex produces $35 billion annually that can be used for growth investment. Obviously, even without currency restrictions, only a fraction of this staggering resource is ever earmarked for overseas investment....and just a fraction of this fraction for investment in developing nations.

In addition to extractive industries and conventional manufacturing companies looking for growth opportunities, a third type of multinational corporation exists. This is the technology-intensive company, the firm that develops new products that often are of great value to society, such as computers, electronic equipment or drugs. Many such products are sought -- even demanded -- by other nations, developed and developing alike.

If the expression "multinational corporation" seems imprecise, it is a model of clarity compared with the ambiguity implicit in the term "developing nation," or in any of the various euphemisms we may choose to substitute. Everyone knows, of course, that such nations differ drastically. But perhaps because the point is so blatantly obvious, we sometimes tend to ignore it. Theodore Geiger's "The Conflicted Relationship" has documented how disastrous this can be.

In view of the major cultural and economic differences within nations, one of the most important contributions of the Peterson task force report surely is its insistence that the developing nations, themselves, take the lead in their economic planning and in setting their own economic priorities. The World Bank's plans to help with such planning seem equally farsighted. Hopefully, in the competition for scarce resources, water hygiene will take precedence over prestige hospitals, trained mechanics over PhDs.

In addition to keeping in mind the fundamental structural and cultural differences between nations, we must also remember that all

nations change. For example, it is a common occurrence today for multinational business to find itself negotiating in a developing nation with Ministers or other top governmental advisors who have done graduate work in American universities. These officials know, in depth, the policies and practices of American corporations at home and abroad.

Increasingly, the Ministers in developing nations know exactly what they want. And their wishes usually are highly rational within the political context in their own countries. Moreover, multinational corporations find themselves increasingly trapped between clashing viewpoints. For example, Finance Ministers are strongly interested in conserving exchange currency. What their regulations may ask of a multinational subsidiary may conflict directly with the policies preferred by -- let us say -- the Minister of Development, whose interest lies in creating jobs and raising technical competence.

Whatever middle course the corporation elects to follow, neither Minister is pleased. Each may feel slightly betrayed. The fact that the situation is irreconcilable doesn't appreciably lessen the abuse that sometimes is heaped on the company's head. I would say that, more and more, strident criticism is becoming a fact of life that multinational corporations must learn to live with.

Unfortunately, much of the discussion and reporting of the relationship between corporations and governments is couched in the rhetoric of combat: winners and losers. The more accurate analogy -- it is Charles Kindleberger's -- should be that of the "non-zero-sum game."

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In such a game, one player's gain does not depend upon the other's loss. Both can win, or both can lose. The concept is precisely descriptive of what should be -- and often is -- the relationship between the multinational corporation and a developing nation.

Kindleberger and others have called attention to a paradox that many -- perhaps most -- multinational corporations have experienced: success breeding disenchantment. I think we can generalize usefully about this. In the days of courtship and in the early phases of operations, the subsidiary has the controlling hand. But not for long. As a company grows and prospers, the government sometimes tends to feel that it made a bad bargain and will try to "renegotiate" for a larger share of the profits. In such cases, political realities often win out over the sanctity of contracts. If the company is wise, it will make the best of the unwanted situation and remember that some quid pro quo often is possible even then.

Knowledgeable and experienced companies will negotiate for the best deal they can make, a position that is understood by most developing countries. Such countries, of course, are aware that bargaining is a game for two, and many are becoming highly proficient at it.

A major cause of misunderstanding has been that while multinational corporations respond to business imperatives, the governments of developing nations must react to political realities. The company often conceives the scope and nature of its activities differently than does the host government. It often views its profit needs differently. So the two find themselves talking at cross purposes, even to the point of

reciprocal accusations of subversion and sabotage. When relationships reach this nadir, there is no point in talking about a "non-zero-sum game." The two antagonists are not even engaged in the same game.

Things usually are by no means this black. Yet if you superimpose the aims and needs of a company as the company sees them, on what should be its aims and needs as the government interprets them, the two lists seldom match totally. This is especially true after a company has been on the scene for a while, and its product lines -- not to mention governments -- have changed. At this juncture, both sides should forgo the temptation to talk about "basic incompatibilities," assuming instead that neither side is going to get everything that it wants but that each can get something.

I fear that something approaching formalized misunderstanding is beginning to characterize much of our thinking about relationships between multinational corporations and developing nations. Corporations rightly emphasize their contributions. They furnish needed technology. They increase managerial and technical skills. They create jobs. They infuse new business concepts. They make possible backup industries.

Developing nations, however, tend to place the emphasis elsewhere. They argue multinational corporations have divided loyalties and, in a showdown, must put company interests over those of the host nations. They object that multinational corporations make central decisions about what a subsidiary may export, and to whom. They note further that American-based corporations are limited by U.S. regulations as to both the nature and the recipients of their exports. They see multinational corporations as

threats to infant or small local industries, with virtually a monopolistic lock on many major products and with marketing and financial resources that cannot be matched locally. They sometimes accuse multinational corporations of luring away talented people by paying unmatchable wages, and of drying up credit sources by attracting the available loan money. The cumulative effect of such accusations -- when pushed to the extreme -- is that the corporation is seen as a threat to local economic autonomy.

The local manager of the multinational corporation tends to find such allegations overstated. He sees the shortsightedness of the government's over-reliance on short-term measures -- import and investment restrictions, tariffs, quotas and the like. Feeling somewhat harassed, he tends to forget that political expediency can mean the survival of governments and a good deal of order instead of chaos.

We can almost measure the degree of misunderstanding when Chile's Foreign Minister, Dr. Gabriel Valdes -- in a summary of the consensus of Viña del Mar -- makes this statement: "...we have reached the point where Latin America is contributing to the development of the United States, and not the other way around." The implication would seem to be that it should be one way or the other, when -- with the "non-zero-sum game" concept -- each should be contributing to the other. At least this should be true of private investment.

Partisans of the position that American is undermining -- rather than supporting -- the developing world are quick with statistics. One fault that often is to be found in such statistics is that they compare income from the total investment base in such countries -- sometimes dating back for generations -- with investments over a limited period. More to the point, they say nothing about what such investments have done for the local economies, where they were also at work creating income and savings, building economic infrastructure, and sparing foreign exchange, all of which have multiplier effects.

A recent study by Herbert K. May for the Council for Latin America undertook a broader look at the question of the impact of foreign investment. The findings would seem to argue forcefully for the advantages of foreign investment to the developing nations, even in strictly economic terms.

The May survey found that, for the period from 1965 through 1968, U. S. investment made a positive contribution to Latin America's balance of payments of $8.55 billion annually. Let us take Colombia as a specific example: of 116 companies included in the tablulation, 75 were more than 95% U.S.-owned. In only 22 was the U.S. participation less than 50%. The 116 companies represented an overall investment of about $297 million, including $61 million brought into Colombia in the 1964-1968 period. Their remittances for this five-year period -- dividends, royalties and payments for technical services -- totaled 15.4% of the companies' total invested capital. That means that the annual rate of all remittances was merely 3.1% of invested capital. This is hardly a picture of crass exploitation. Total return to the

United States, of course, is considerably higher than this figure since there is also the return from arm's-length sales of intermediates within the corporation to subsidiaries. A national firm abroad, however, would pay the same price for such materials.

I find it noteworthy that the Foreign Minister whom I quoted before, in describing his country's new investment guidelines, singled out technology-centered industry for special attention. In his eyes, certainly foreign investment per se was not monolithic. The Minister acknowledged what he called an "imperative need to contract with foreign enterprises to acquire technology." In this he is right. At the same time, he must recognize that the multinational corporations that possess this technology will be interested in entering his country only as respected partners in a business transaction; they are not interested in being looked upon as objects to be used and discarded.

The Minister argues that, because of its small market size, his nation has been unable to develop its own technological potential. Consolidation through the Andean Treaty, he feels, should provide a useful stimulus. I hope he is right. Only a certain amount of the technology created within the developed nations is applicable to the developing world, and seldom are the technological products ideally suited to their new environment. Much could -- indeed, must -- be done through local adaptation of innovation. The Peterson report again is to be applauded for its proposal for a U. S. International Development Institute to support and assist with such research.

Unfortunately, the ability to reach multiple markets is but one factor among many that have contributed to U.S. strength in the technological field. Unpopular though the multinational corporation may be politically, it remains the world's prime source of marketable technology. Any developing nation or region that has illusions of "going it alone" technologically within the foreseeable future is courting disappointment. Obviously, though, we are again stumbling over a word. "Technology" is both a hand plough and a scanning electron microscope. Vast areas exist -- especially in fields such as agriculture and civil engineering -- where local ingenuity can make major contributions. But the enormously complex processes needed for the creation of high technology will long remain out of the creative reach of developing nations. Still, such nations will continue to need a selection of high-technology products.

Since both governments and corporations must make their way together, it seems to me that today's situation demands less rhetoric and more flexibility, more pragmatism. Multinational corporations must accept political realities as they find them, and try to gain acceptance of their point of view by showing respect for the views of others. Equally important, developing governments -- in some instances -- must ask themselves critically whether self-serving polemics against private enterprise are worth the price.

We must be on guard against any expectation that an early effect of a rising standard of living will be a reduction of social tensions. A taste of a better life is intoxicating, and performance can never

keep pace with expectations. I suspect that -- with the best possible will and effort -- we can expect years of continued discord, and we must anticipate this so as not to be discouraged by it. The assumption that stability must be a precondition for development seems to me to invite a standoff. Perhaps neither the Pearson nor the Peterson reports gave sufficient weight to this factor.

Both the Pearson and the Peterson commissions -- through their solid findings and recommendations -- have performed commendable service in identifying problem areas and sketching out approaches to their solution. They have, of course, taken an overall view, and businessmen will find some of their suggestions unrealistic.

Take the question of incentives, for example. In one form or another, incentives are necessary to attract investment. Most developing nations will offer incentives as a subsidy for import substitution. A good incentive for a bad proposition is still bad business, however. Both countries and corporations should show a high level of restraint, unless it can be shown that the proposal can soon be economic on its own merits. Otherwise, the new company will become another non-economic monument to national ego and a drain rather than an asset.

Also, the popular proposal that a multinational corporation should be required to function with a local partner within a developing nation leaves something important unsaid. What is not mentioned is that the

local company should also bring something into the arrangement -- a marketing organization, for example, or a production capacity. Otherwise, the relationship can become tense. For any multinational corporation, I would recommend a simulation technique -- game-playing -- that we employed with the Tata enterprises as we explored a joint venture. We constructed many contingencies, and analyzed what we would do if they were to arise. We thereby entered the merger with a clear understanding of our mutual roles. The effective teamwork that has characterized our relationship with our Indian partner undoubtedly stems in large measure from this exercise in candor.

The industry with which I am associated has not been seriously hampered in its investments in developing nations by the U.S. controls on capital exports. Our industry does not require excessive capital investments, however. I assume that other industries may well be encountering problems. The controls must certainly have discouraged even feasibility studies for many companies.

With regard to investments, I would concur with the Pearson commission recommendation that developing nations restructure their tax structure to encourage profit reinvestment by foreign companies. But I would insist that this should be done with great sensitivity. The point must not be forgotten that a multinational corporation has many options, and it has no reason to choose an economic straitjacket. The Pearson commission, itself, recognizes this.

The tax policy of the U.S. and other developed nations should be used as an instrument to promote investment in less developed

countries. The past three administrations have proposed tax incentives for this purpose, and each proposal has been defeated by considerations concerning the methods by which incentive should be provided. A simple solution would be to make tax free the income from qualified investments in manufacturing industries in developing countries. All elements of the U.S. economy should recognize that U.S. foreign investments increase exports from the United States.

Investment credits and deductions could provide additional tax incentives for investing in less developed countries. Germany, for example, has employed this approach increasingly over the past ten years. Presently, they provide a 15% investment credit and a 42% tax deduction for the establishment of a reserve which is restored to taxable income on a deferred amortization basis. I would suggest that we review the tax incentives used by other countries and adopt those that seem best suited to encouraging investment of U.S. capital in less developed countries.

A number of revisions could be made within our tax laws to facilitate investment in less developed countries by providing tax benefit for losses. The risk involved in investing in less developed countries could be substantially mitigated by extending tax deductions to U.S. investors with respect to currency exchange losses incurred by foreign subsidiaries. These losses are now extended to companies that operate through branches in foreign countries, and there seems to be no reason why similar treatment could not be accorded to operations conducted through subsidiary corporations. Another draw-

back contained in Federal tax law exists with respect to the tax treatment of worthless securities. These losses usually confront investors in the form of government expropriation, either explicit or de facto. The tax law requires that such losses be treated as capital losses, with limited tax benefit except in situations where the U. S. investor owns at least 95% of the stock of the corporation becoming worthless. In many situations local exigencies require that investment be conducted with substantial participation by local investors. The limitation on tax benefit from losses on securities discourages such investment. I feel, incidentally, that all of these proposals are compatible with the DISC recommendations of the Treasury Department, which I heartily endorse.

The United States should use its influence in every way it can to encourage regionalism. The web of tariff and import restrictions that most developing nations have felt obliged to wrap themselves in virtually excludes economic escape. Tariff restrictions, for example, may compel a multinational corporation to erect some sort of manufacturing plant within a developing nation, with the alternative being the loss of the market. Competition is vital in the free enterprise system, but it must be recognized that these same restrictions can engender a rash of small plants that are uneconomic. Manufacturing for an entire region could change this pattern and result in economies for the entire area.

The emphasis by the Peterson task force on the creation of stronger international financing and international planning institutions seems to me to be well placed. The concept of the Overseas Private Investment Corporation to mobilize private-sector participation has great merit,

although experience with it so far would seem to indicate that stronger incentives will have to be forthcoming. Perhaps something approaching investment guarantees will have to be devised. The problem, of course, is that investments will continue to be judged on their own merits. Corporations will shy away from questionable investments, regardless of guarantees.

Recent trends to reduce United States foreign aid have been harmful both psychologically and practically. Such funds often have been directed to creating economic infrastructure. As such, they have been of fundamental economic importance to both the recipient nation and all corporations doing business there. Obviously, what such aid can do is very limited. But -- if at all possible -- it should be continued and increased.

The application of U. S. antitrust law abroad obviously poses a thorny problem, in part because it is so little understood. In many instances, it is quite possible for U. S. competitors to work together in the interests of developing nations. But corporations understandably remain nervous. The problem, serious as it is, has been magnified out of all proportion, since the idea of the application of American laws abroad has been construed frequently as blatant U. S. intervention in the affairs of other governments. It may be that the lack of clarity within the law has been an inhibiting factor. In any event, we must be on guard against using the specter of antitrust as an excuse for inaction when our real motivations lie elsewhere.

It has been estimated that seven trillion dollars would have to be invested to bring the $500 annual income of one and three-quarter billion people up to $750 a year -- a level that would be one half the $1,500 United States average. Seven trillion dollars is 14 times the total capital that existed in the world in 1967. Therefore, any governmental assistance program must seem insignificant when compared to to the magnitude of the need. This is no reason for turning our backs. Because aid can be pinpointed to key problems, it can have a multiplier effect. The Peterson task force recommendation that -- where feasible -- more aid funds should be channeled through international agencies would help remove the feeling that aid is tainted and open innumerable doors.

As we enter the decade of the '70's, America has good reason to take stock of its position in world economic affairs. Patterns are different. Among other things, high technology -- America's forte -- has acquired a force that would have been unimaginable a generation ago. High technology now contributes an estimated $9 billion towards a United States trade surplus, compared with $1 billion by conventional manufacturing. But expertise in technology does not equip us mentally or materially to deal with penury. The Unites States -- in the context of its priorities -- must first find its answer to the question: what can -- and should -- we do to aid two-thirds of the world escape the crushing yoke of national poverty?

While developing nations finance 85% of their investments from their own sources, foreign private investment, including that by multi-

national corporations -- selectively applied -- can complement and stimulate this process. The challenge is largely one of creating the proper incentives, and this applies to developed and developing nations alike. We -- the developed nations -- can offer preferred treatment to blocs, although we should not permit any single nation to play a double game as Japan has done.

It is impossible to be sanguine about the future of the developing nations: we must be deeply concerned.

As these nations -- with our help -- examine the profundity of their problems and turn to us with suggestions for collaborative efforts, we must heed when we can.

Progress -- if we are to know progress -- demands mutual respect, free of paternalism. It asks broad application of efficacious techniques in education, communications and population control, as well as major efforts to raise levels of health and nutrition. Some of these techniques are within the competence of the multinational corporations, which -- if the problems can be factored into soluble components -- are capable of accepting the challenge with imagination and skill. We must realize that, beyond the technical problems, are enormous barriers of tradition and beliefs. Population control offers few difficulties, technically. In application, the techniques have failed conspicuously.

At the moment, the future relationship between the multinational corporation and developing nations is clearly in doubt. As a "non-zero-sum game," this should not be. If corporation management and government leaders can display patience and courage in the face of taunts and tension, the future need not be desperate. If they can display wisdom, much can be accomplished.

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Relations between multinational corporations and developing countries too often assume the character of an adversary proceeding. In reality, the gain of one does not depend on the loss of the other. Both can win—both can lose.

The Multinational Corporation in the Third World

A. T. KNOPPERS

THE multinational corporation can be said to have something in common with happiness or misery: no one can quite define it, but you always know when it is there. It is probably enough of a definition to say that the multinational corporation is a business organization that sees the world—or a goodly portion of it—as its market and acts to make the most of its opportunities on a supranational basis.

By this definition or any other, most multinational corporations—or to use the more accurate term, multinational enterprises—are U.S.-based. This, of itself, puts certain constraints upon their operations and complicates decision making, when compared with the relatively greater freedom of some of their European-based counterparts. Of the 500 largest corporations in the world, it is estimated that 306 have headquarters in the United States. Accumulated private direct foreign investment by U.S. industry is estimated at $65 billion.

Approximately 30% of this investment abroad, however, is in Europe. The total long-term European investment in the United States, currently about $26 billion—largely portfolio investment—just about evens out with U.S. investment there, the latter being largely direct investment. Since Europe is rapidly developing its economic muscle, U.S. investment in Europe does not pose a threat.

A look at the developing world—about two-thirds of the world—presents a different picture. The World Bank's Pearson Commission, working with 1968

statistics, found that direct industrial investments that year by developed nations in the developing countries were only $2.7 billion. Although the statistics are not completely compatible, compare this with U.S. industry's direct investment of $2.5 billion in France alone in the year 1965. Of the total cumulative industrial investment in developing countries of $30 billion, virtually half was in petroleum, mining or smelting, with only a little over a quarter in manufacturing.

While all companies have a goal of making a profit, there are as many kinds of multinational corporations as there are motivations for going abroad. Extractive industry goes abroad because that is where mineral sources lie. Other companies go abroad simply to find new markets.

In addition to extractive industries and conventional manufacturing companies looking for growth opportunities, a third type of multinational corporation exists. This is the technology-intensive company, the firm that develops new products, often of great value to society, such as computers, electronic equipment or drugs. Many such products are sought—even demanded—by other nations, developed and developing alike.

Developing Nations Change

If the expression "multinational corporation" seems imprecise, it is a model of clarity compared with the ambiguity implicit in the term "developing nation," or in any of the various euphemisms we may choose to substitute. Such nations differ drastically.

In view of the major cultural and economic differences within nations, one of the most important contributions of the Peterson Task Force report surely is its insistence that the developing nations themselves take the lead in their economic planning and in setting their own economic priorities. The World Bank's plans to help with such planning seem equally far-sighted. Hopefully, in the competition for scarce resources, water hygiene will take precedence over prestige hospitals, trained mechanics over PhDs.

In addition to keeping in mind the fundamental structural and cultural differences between nations, we must also remember that all nations change. For example, it is a common occurrence today for multinational business to find itself negotiating in a developing nation with ministers or other top governmental advisors who have done graduate work in U.S. universities. These officials know, in depth, the policies and practices of U.S. corporations at home and abroad.

Increasingly, the ministers in developing nations know exactly what they want. Their wishes usually are highly rational within the political context in their own countries. Moreover, multinational corporations find themselves increasingly trapped between clashing viewpoints. For example, finance ministers are strongly interested in conserving exchange currency. What their regulations may ask of a multinational subsidiary may conflict directly with the policies preferred by—let us say—the Minister of Development, whose interest lies in creating jobs and raising technical competence.

Whatever middle course the corporation elects to follow, neither minister is pleased. Each may feel slightly betrayed. The fact that the situation is irreconcilable doesn't appreciably lessen the abuse that sometimes is heaped on the company's head. I would say that, more and more, strident criticism is becoming a fact of life that multinational corporations must learn to live with.

Unfortunately, much of the discussion and reporting of the relationship between corporations and governments is couched in the rhetoric of combat: winners and losers. The more accurate analogy—it is Charles Kindleberger's—should be that of the "non-zero-sum game." In such a game, one player's gain does not depend upon the other's loss. Both can win, or both can lose. The concept is precisely descriptive of what should be—and often is—the relationship between the multinational corporation and a developing nation.

Kindleberger and others have called attention to a paradox that many—perhaps most—multinational corporations have experienced: success breeding disenchantment. In the days of courtship and in the early phases of operations, the subsidiary has the controlling hand. As a company grows and prospers, the

government sometimes tends to feel that it has made a bad bargain and will try to "renegotiate" for a larger share of the profits. In such cases, political realities often win out over the sanctity of contracts. If the company is wise, it will make the best of the unwanted situation and remember that some *quid pro quo* often is possible, even then.

Knowledgeable and experienced companies will negotiate for the best deal they can make, a position that is understood by most developing countries. Such countries, of course, are aware that bargaining is a game for two, and many are becoming highly proficient at it.

Business and Politics

A major cause of misunderstanding has been that, while multinational corporations respond to business imperatives, the governments of developing nations must react to political realities. The company often conceives the scope and nature of its activities differently than does the host government. It often views its profit needs differently. So the two find themselves talking at cross purposes, even to the point of reciprocal accusations of subversion and sabotage. When relationships reach this nadir, there is no point in talking about a non-zero-sum game. The two antagonists are not even engaged in the same game.

Things usually are by no means this black. Yet if you superimpose the aims and needs of a company, as the company sees them, on what should be its aims and needs as the government interprets them, the two lists seldom match totally. This is especially true after a company has been on the scene for a while, and product lines—not to mention governments—have changed. At this juncture, both sides should forgo the temptation to talk about "basic incompatibilities," assuming instead that neither side is going to get everything that it wants but that each can get something.

Something approaching formalized misunderstanding is beginning to characterize much of the thinking about relationships between multinational corporations and developing nations. Corporations rightly

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emphasize their contributions. They furnish needed technology. They increase managerial and technical skills. They create jobs. They infuse new business concepts. They make possible backup industries.

Developing nations, however, tend to place the emphasis elsewhere. They argue that multinational corporations have divided loyalties and, in a showdown, must put company interests over those of the host nations. They object that multinational corporations make central decisions about what a subsidiary may export, and to whom. They note further that U.S.-based corporations are limited by U.S. regulations as to both the nature and the recipients of their exports. They see multinational corporations as threats to infant or small local industries, with virtually a monopolistic lock on many major products and with marketing and financial resources that cannot be matched locally. They sometimes accuse multinational corporations of luring away talented people by paying unmatchable wages and of drying up credit sources by attracting the available loan money. The cumulative effect of such accusations—when pushed to the extreme—is that the corporation is seen as a threat to local economic autonomy.

The local manager of the multinational corporation tends to find such allegations overstated. He sees the shortsightedness of the government's over-reliance on short-term measures—import and investment restrictions, tariffs, quotas and the like. Feeling somewhat harassed, he tends to forget that political expediency can mean the survival of governments and a good deal of order instead of chaos.

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the point where Latin America is contributing to the development of the United States, and not the other way around." The implication would seem to be that it should be one way or the other, when—with the non-zero-sum game concept—each should be contributing to the other. At least, this should be true of private investment.

Partisans of the position that the United States is undermining—rather than supporting—the developing world are quick with statistics. One fault that often is to be found in such statistics is that they compare income from the total investment based in such countries—sometimes dating back for generations—with investments over a limited period. More to the point, they say nothing about what such investments have done for the local economies, where they were also at work creating income and savings, building economic infrastructure and sparing foreign exchange, all of which have multiplier effects.

Foreign Investment Advantageous

A recent study by Herbert K. May for the Council of the Americas undertook a broader look at the question of the impact of foreign investment. The findings would seem to argue forcefully for the advantages of foreign investment to the developing nations, even in strictly economic terms.

The May survey found that, for the period from 1965 through 1968, U.S. investment made a positive contribution to Latin America's balance of payments of $8.55 billion annually. Colombia is a specific example: of 116 companies included in the tabulation, 75 were more than 95% U.S.-owned. In only 22 was the U.S. participation less than 50%. The 116 companies represented an over-all investment of about $297 million, including $61 million brought into Colombia in the 1964–1968 period. Their remittances for this five-year period—dividends, royalties and payments for technical services—totaled 15.4% of the companies' total invested capital. That means that the annual rate of all remittances was merely 3.1% of invested capital. This is hardly a picture of crass exploitation. Total return to the United States, of course, is considerably higher than this figure since there is also the return from arm's-length sales of intermediates within the corporation to subsidiaries. A national firm abroad, however, would pay the same price for such materials.

It is noteworthy that the Chilean Foreign Minister, in describing his country's new investment guidelines, singled out technology-centered industry for special attention. In his eyes, certainly, foreign investment per se was not monolithic. The Minister acknowledged what he called an "imperative need to contract with foreign enterprises to acquire technology." In this he is right. At the same time, he must recognize that the multinational corporations possessing this technology will be interested in entering his country only as respected partners in a business transaction; they are not interested in being looked upon as objects to be used and discarded.

The Minister argues that, because of its small market size, his nation has been unable to develop its own technological potential. Consolidation through the Andean Treaty, he believes, should provide a useful stimulus. He may be right, but only a certain amount of the technology created within the developed nations is applicable to the developing world, and seldom are the technological products ideally suited to their new environment. Much could —indeed, must—be done through local adaptation of innovation. The proposal for a U.S. International Development Institute to support and assist with such research is to be applauded.

Unfortunately, the ability to reach multiple markets is but one factor among many that have contributed to U.S. strength in the technological field. Unpopular though the multinational corporation may be politically, it remains the world's prime source of marketable technology. Any developing nation or region that has illusions of "going it alone" technologically within the foreseeable future is courting disappointment. Obviously, though, we are again stumbling over a word. "Technology" is both a hand plough and a scanning electron microscope. Vast areas exist—especially in such fields as agriculture and civil engineering—where local ingenuity can make major contributions. While the enormously

complex processes needed for the creation of high technology will long remain out of the creative reach of developing nations, these nations will continue to need a selection of high-technology products.

Since both governments and corporations must make their way together, today's situation demands less rhetoric and more flexibility, more pragmatism. Multinational corporations must accept political realities as they find them and try to gain acceptance of their point of view by showing respect for the views of others. Equally important, developing governments—in some instances—must ask themselves critically whether self-serving polemics against private enterprise are worth the price.

We must be on guard against any expectation that a rising standard of living will effect a reduction of social tensions. A taste of a better life is intoxicating, but performance can never keep pace with expectations. With the best possible will and effort, we must expect years of continued discord and not be discouraged by it. The assumption that stability must be a precondition for development invites a standoff. Perhaps neither the World Bank's Pearson nor the administration's Peterson reports gave sufficient weight to this factor.

Problem Areas

Both the Pearson and the Peterson commissions—through their solid findings and recommendations—have performed a commendable service in identifying problem areas and sketching out approaches to their solution. They have, of course, taken an over-all view, and businessmen will find some of their suggestions unrealistic.

Take the question of incentives, for example. In one form or another, incentives are necessary to attract investment. Most developing nations will offer incentives as a subsidy for import substitution. A good incentive for a bad proposition is still bad business, however. Both countries and corporations should show a high level of restraint, unless it can be shown that the proposal can soon be economic on its own merits. Otherwise, the new company will become another non-economic monument to national ego and a drain rather than an asset.

Also, the popular proposal that a multinational corporation should be required to function with a local partner within a developing nation leaves something important unsaid. What is not mentioned is that the local company should also bring something into the arrangement—a marketing organization, for example, or a production capacity. Otherwise, the relationship can become tense. In this situation, the multinational corporation might try a simulation technique—game-playing—such as Merck employed with the Tata enterprises in exploring a joint venture. The two firms constructed many contingencies and analyzed what they would do if these contingencies were to arise. They thereby entered the merger with a clear understanding of their mutual roles. The effective teamwork that has characterized the relationship with the Indian partner undoubtedly stems in large measure from this exercise in candor.

The drug industry has not been seriously hampered in its investments in developing nations by the U.S. controls on capital exports. The industry does not require excessive capital investments, however. Other industries may not be in this position. Controls must certainly have discouraged even feasibility studies for many companies.

With regard to investments, the Pearson commission's recommendation that developing nations restructure their tax system to encourage profit reinvestment by foreign companies is sound. But this should be done with great sensitivity. The point must not be forgotten that a multinational corporation has many options, and it has no reason to choose an economic straitjacket. The Pearson commission recognizes this.

The tax policy of the United States and other developed nations should be used as an instrument to promote investment in less developed countries. The past three administrations have proposed tax incentives for this purpose, and each proposal has been defeated by considerations concerning the methods by which incentives should be provided. A simple solution would be to make tax free the income from qualified investments in manufacturing industries in

developing countries. All elements of the U.S. economy should recognize that U.S. foreign investments increase exports from the United States.

Investment credits and deductions could provide additional tax incentives for investing in less developed countries. Germany, for example, has employed this approach increasingly over the past ten years. Presently, they provide a 15% investment credit and a 42% tax deduction for the establishment of a reserve which is restored to taxable income on a deferred amortization basis. The United States should review the tax incentives used by other countries and adopt those that seem best suited to encouraging investment of U.S. capital in less developed countries.

A number of revisions could be made within U.S. tax laws to facilitate investment in less developed countries by providing tax benefits for losses. The risk involved in investing in less developed countries could be substantially mitigated by extending tax deductions to U.S. investors with respect to currency exchange losses incurred by foreign subsidiaries. These losses are now extended to companies that operate through branches in foreign countries, and there seems to be no reason why similar treatment could not be accorded to operations conducted through subsidiary corporations. Another drawback contained in Federal tax law exists with respect to the tax treatment of worthless securities. These losses usually confront investors in the form of government expropriation, either explicit or de facto. The tax law requires that such losses be treated as capital losses, with limited tax benefit except in situations where the U.S. investor owns at least 95% of the stock of the corporation that becomes worthless. In many situations local exigencies require that investment be conducted with substantial participation by local investors. The limitation on tax benefit from losses on securities discourages such investment.

The United States should use its influence in every way it can to encourage regionalism. The web of tariff and import restrictions that most developing nations have felt obliged to wrap themselves in virtually excludes economic escape. Tariff restrictions, for example, may compel a multinational corporation to erect some sort of manufacturing plant within a developing nation, the alternative being the loss of the market. Competition is vital in the free enterprise system, but it must be recognized that these same restrictions can engender a rash of small plants that are uneconomic. Manufacturing for an entire region could change this pattern and result in economies for the entire area.

Assistance

The emphasis by the Peterson Task Force on the creation of stronger international financing and international planning institutions seems to me to be well placed. The concept of the Overseas Private Investment Corporation to mobilize private-sector participation has great merit, although experience with it so far would seem to indicate that stronger incentives will have to be forthcoming. Perhaps something approaching investment guaranties will have to be devised. The problem, of course, is that investments will continue to be judged on their own merits. Corporations will shy away from questionable investments, regardless of guaranties.

Recent trends to reduce U.S. foreign aid have been harmful both psychologically and practically. Such funds have often been directed toward the creation of economic infrastructure. As such, they have been of fundamental economic importance to both the recipient nation and all corporations doing business there. Obviously, what such aid can do is very limited, but —if at all possible—it should be continued and increased.

It has been estimated that seven trillion dollars would have to be invested to bring the $500 annual income of one and three-quarters billion people up to $750 a year—a level that would be one-half the U.S. average of $1,500. Seven trillion dollars is 14 times the total capital that existed in the world in 1967. Therefore, any governmental assistance program must seem insignificant when compared to the magnitude of the need. This is no reason for turning our backs. Because aid can be pinpointed to key problems, it can have a multiplier effect. The Peterson Task Force recommendation that—where feasible

—more aid funds should be channeled through international agencies, would help remove the feeling that aid is tainted and open innumerable doors.

The application of U.S. antitrust law abroad obviously poses a thorny problem, in part because it is so little understood. In many instances, it is possible for U.S. competitors to work together in the interests of developing nations. But corporations understandably remain nervous. The problem, serious as it is, has been magnified out of all proportion, since the idea of the application of U.S. laws abroad has been construed frequently as blatant U.S. intervention in the affairs of other governments. It may be that the lack of clarity within the law has been an inhibiting factor. In any event, we must be on guard against using the specter of antitrust as an excuse for inaction when our real motivations lie elsewhere.

As we enter the decade of the '70s, the United States has good reason to take stock of its position in world economic affairs. Patterns are different. Among other things, high technology has acquired a force that would have been unimaginable a generation ago. High technology now contributes an estimated $9 billion towards a U.S. trade surplus, compared with $1 billion by conventional manufacturing. But expertise in technology does not equip us mentally or materially to deal with penury. The United States—in the context of its priorities—must first find its answer to the question: what can—and should—we do to aid two-thirds of the world escape the crushing yoke of national poverty?

While developing nations finance 85% of their investments from their own sources, foreign private investment, including that by multinational corporations—selectively applied—can complement and stimulate this process. The challenge is largely one of creating the proper incentives, and this applies to developed and developing nations alike. The developed nations can offer preferred treatment to blocs, although they should not encourage one-sided, preferential tactics by any particular country.

It is impossible to be sanguine about the future of the developing nations: we must be deeply concerned.

As these nations—with assistance—examine the profundity of their problems and turn to us with suggestions for collaborative efforts, we must heed when we can.

Progress demands mutual respect, free of paternalism. It asks broad application of efficacious techniques in education, communications and population control, as well as major efforts to raise levels of health and nutrition. Some of these techniques are within the competence of the multinational corporations, which—if the problems can be factored into soluble components—are capable of accepting the challenge with imagination and skill. Beyond the technical problems, there are enormous barriers of tradition and beliefs. Population control offers few difficulties, technically. In application, the techniques have failed conspicuously.

At the moment, the future relationship between the multinational corporation and developing nations is clearly in doubt. In a non-zero-sum game, this should not be. If corporation management and government leaders can display patience and courage in the face of taunts and tension, the future need not be desperate. If they can display wisdom, much can be accomplished.

(From the House Committee on Science and Astronautics publication "Applied Science and World Economy")

DEVELOPMENT AND TRANSFER OF MARKETABLE TECHNOLOGY IN THE INTERNATIONAL CORPORATION: A NEW SITUATION

ANTONIE T. KNOPPERS [1]

Our subject of today is timely and fascinating: it deals with the place of present and future "applied science"—I will use mostly the word "technology"—in the "world economy," the economic life of Nation-States and regional groupings.

Generally speaking, mankind enters the third part of this century with an enormous -largely predictable—potential of technology to serve useful ends. The development of such technology is undergoing unusual acceleration. It is unusual in the sense that the change is not only quantitative but also—and especially—qualitative. In many fields the chanceful character of this change has given place to a deliberate "forcing" of new usable technology. This development is especially apparent in the physical field, but is now also more and more to be seen in chemistry. We are also on the verge of a revolution in biological technology. Of many factors making this change possible, the computer has been a key.

There is not doubt that technology will change the economies and social structures of the developed world into "postindustrial" or "advanced industrial" societies (to use Herman Kahn's terminology). It can also uplift the social and economic life of the poorer nations, but realization of technology's potential here is very difficult and less likely.

The problem is that great inequality exists in the technological momentums of nations. This is a matter of concern, because advanced technology is self-nourishing. Superior technology creates the resources and attracts the brains that are needed for its own improvement with the result that lagging nations will find it increasingly difficult to catch up with the technological leaders. Hence the problem of transfer of usable technology becomes more and more important.

As an instrumentality for the transfer of technology, a new force has emerged: the large internationally active corporation, especially that based and owned in the United States of America. The bulk of new marketable technology is developed by these giants. Moreover, worldwide distribution of this technology takes place inside the international corporation, which is active through subsidiaries within the sphere of sovereignty of nation-states. This new situation creates many problems. A confrontation is occurring.

Still it must be realized that "technology" is an expression of what people or—in broader context—nation-states want and the priorities they establish for themselves. It is a servant for the realization of social concepts.

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Already de Tocqueville recognized in the United States of America a strong drive toward "applied science," while valuing the "theoretical basis" necessary for application. In 1967, Servan-Schreiber, in his "Le défi américain" (The American Challenge) described this question of attitude as follows: "Such is Europe before the challenge of growth, before the challenge of power. Such is the core of the problem. It no longer exists in statistics, but in minds. Which political forces, which ideas, which men will open them to change?" Indeed, technology is an expression of people, nations—a result of political and social will.

The development of usable, marketable technology is a complex process. It is therefore important that, considering technology as a social tool, we have a good insight into its dynamics. Also in this article, inequalities in development of technology and the question of "transfer" will be analyzed. The latter is a major problem. Especially the transfer of technology to the underdeveloped nations of the world for improved comprehension and action.

DEVELOPMENT OF NEW TECHNOLOGY

The dynamics of the development of technology center around the factors which create the invention (a primary reduction to practice of an "idea") and its transfer into an innovation (usable technology). Nearly always an invention is a reaction to a need; its change into usable technology fulfills that need. The field treated here deals with "marketable technology," which results from an economic act. I do not discuss here the question of whether large corporations can control this demand by, in fact, creating it. Galbraith, in my view goes too far in developing this thesis, see "The New Industrial State." Kaysen (Human Values and Economic Policy—1967) put it in a very refined way: "The objective of the dispenser and marketer is to discover, to the extent that he can, what consumers will, in the event, readily learn to like." The study of the direction a market will take can be particularly important. As a practitioner in the development of marketable technology, I clearly recognize the above possibilities in consumer product marketing. However, I have observed that such "directed" or "learned" demand can be very important initially, but that later in mass use the product shakes out to its value. After some time value and sales volume come into balance. The final judgment of the market is often remarkably precise.

From a practical point it is important to make a sharp distinction between an invention and its transition to marketable technology. Inventions are produced by a rather small elite of highly trained, imaginative scientists with a grasp of technology. But to change such an invention into a marketable product is a difficult process, and one in which many other factors must be taken into account: cost, price, and value have to be put in balance; a desired reliability has to be established; a marketing plan and sales estimates must be developed in order to decide on production methods and quantity, etc. It is mostly a road on which disappointments abound and technical compromise is often counted a success. Large groups of people are involved; intricate organization is needed. And often, a marketable product is not achieved.

In the drug industry where I am active, we find many "leads"—substances which have a desired action—but most still fail the tests

of efficacy and safety. It can take years to find a substance which is a worthwhile candidate to subject to rigid animal tests to determine actions, side actions, and toxicity. Even after this, the determination of a compound's potential in human beings is an enormous task itself; a large majority of the substances which reach this stage fail, a few come through. Their introduction to the medical profession must be accompanied by education, by information on how and when to use the drug. By then development costs and value content are of such magnitude that the actual production cost is often a minor part of the total. This fact—basic to highly innovative industry—is often not well understood. And I realize that it is difficult to explain.

To the degree that it is a reaction to economic needs the process of invention and innovation takes place only if certain conditions are met. A prime need is an environment where sufficient science and available technology is present. Invention and innovation are the handiwork of people who are knowledgeable and imaginative. Generally speaking, public opinion overestimates the efforts necessary for an invention and highly underestimates the efforts necessary for its development into a marketable product. The so-called technological gap between the United States and Europe is, for instance, not so much at the invention level, but finds its cause in the second phase: the development level. Europe has been a source of unexploited inventions. When—as traditionally in Europe—an educational system fails to train in sufficient quantities and in proper balance the scientists and technologists and managers needed, the innovating process lags.

To a certain degree, the creation of marketable technology has to compete with other forms of usable technology, especially defense and space technology. They all have their requirements in money, management, and people. The priorities are mostly set by the State. To judge whether the present balance is right falls outside my competence; moreover, for a long time, it will be an unchangeable fact. The question, therefore, whether there is a fall out or spin off of space and defense technology into marketable technology—assuming the latter serves mankind better—is highly important. The argument centers around the distribution of spending on research and development in the United States. In the year 1964, out of an R. & D. total of $19 billion, the U.S. Federal Government spent $12.5 billion, industry $6 billion, and colleges and universities $0.5 billion.

It seems that although direct fall out may be limited (and therefore not well recognized by statistics-conscious economists), the indirect contribution is very substantial. It is important that, of these $12 billion spent by the U.S. Government, 60 percent is expended for projects performed by industry with its facilities and personnel.

This provides industry with an immense pool of technologists well versed in fields of great importance to the future of industrial technology. The interchange and mobility of these researchers within their own companies and between companies guarantee a substantial and essential cross-fertilization and fall out. Possibly one has to live in technology-directed industry to perceive the real implication of fall out. Especially in the fields of refractory materials, sensor instrumentation, and integrated microcircuitry based on solid-state techniques, the spillover to the civilian economy has been considerable. It has also contributed in the training of research managers who can handle complicated projects through sophisticated systems approaches.

Yet this fall out which Europe professes to envy is not a technological cornucopia. It directs attention, funds, management, and technologists to necessary but socially negative projects. To obtain a more durable material, say, as fall out from a space project, is a rather costly and indirect route to innovation.

Another danger in Federal support of research and development is that such projects can become too objective oriented. They could foreclose inapparent but very genuine scientific opportunities. This danger is somewhat lessened by the fact that creative technologists always moonlight a little bit.

Innovations and their change into marketable technology are in part the product of an adequate environment with the proper infrastructure (science, available technology, technologists). Equally important to understanding this process is the realization that it is executed in a corporation, where management is the key.

Basically, it is management that guides the interaction between market research planning and research management; management has to authorize the funds to keep this process (so necessary for survival) going. Through long-range planning it sets goals and guidelines for the future. All this planning and action has to be integrated. Organization, planning, and drive are characteristics of American management. Through these, managers control their future. One must look here to find the roots of the United States-Europe technological gap.

A management concept made IBM, a latecomer, first in the field of computers: IBM understood that planning and making computers was only one part of the business. Hence, the company concentrated heavily on providing "software" and especially on a force of salesmen and sales-service expenses to round out its activities in a total system.

Still the core of the process remains that complex process from invention through innovation to the marketable product (a route that includes the creation of marketing and production plans). Both to finance the process itself (often it is very expensive) and to control and balance risk taking, size has become an important factor. The trend toward large corporations (either conglomerate or covering a broad but defined field) is therefore a natural reaction to the demands of a technological age.

Ford could withstand its Edsel failure and go on to create the Mustang because it had enough resources. The Radio Corp. of America had reached a peak investment of $130 million in R. & D. before profitable markets for its color television receivers finally developed. Given the opportunities associated with size, comparisons between the United States and Europe are instructive: in 1961, the United States of America counted 41 firms with worldwide sales over $1 billion as compared with 10 such firms in the Common Market and Great Britain. In 1966, the figures were 79 and 31. The trend speaks for itself.

This trend toward giantism creates new opportunities and some problems as well. On the one hand those huge corporations will be a mighty force in the increasing exploitation of the unlimited potential of technological innovation; on the other hand, their size of itself contains counterweighing forces which could retard technological progress (oligopolistic trends). It is my conviction, based upon observations as one who lives within industry, that the constructive trend still prevails.

The movement toward large corporations should not obscure the crucial and useful function of a band of highly innovative small firms. Their strength lies in their single purpose, and in the total dedication of their scientist-entrepreneurs (a not too common, but highly effective combination). Such corporations flourish around technical-academic centers; they need a banking community inclined to risk taking. (One finds such firms around Boston; e.g., Route 128, and on the west coast.) Many of these smaller companies have failed, but some have succeeded spectacularly (Varian; Thiokol, Hewlett-Packard, Syntex and many others. Xerox is perhaps the classical example.) Some of their success is based on the fact that some of the countervailing forces which exist in large corporations do not exist in smaller ones: e.g., the latter do not worry about product replacement with its costly retooling, often making production facilities obsolete; on the contrary, the small innovative firms thrive on their relative freedom.

Although many single-purpose, technology-oriented, small firms have prospered because they have a captive or assured government market, this is by no means always the case. Moreover, they keep the large firms awake, on their toes. (A great deal of insight into this subject is to be had in a 1967 report by the U.S. Department of Commerce: "Technological Innovation: Its Environment and Management.")

Most economists and sociologists (see Heilbroner, "The Limits of American Capitalism"; Galbraith, l.c.) agree that the process of innovation—carried out by the industrial corporation—has served the United States well. Although severe disparities still exist within the American economy, total figures (GNP, per capita income, economic growth) are impressive.

But in the light of those disparities, the solution of major social problems (race, urbanization, transport, pollution, education) presents in a variety of forms the paradox of need within abundance. Present and future technology combined with the riches of production could solve these problems.

We see again that technology is the servant of a political will, a social consciousness, a national attitude. There is a hopeful sign that the present mechanism of technology can be used in new systems to achieve social goals. It is ever more hopeful that leaders in government, scholars, and the industrialists agree on this concept. More and more, an active discussion and "trialogue" is developing. All these groups recognize that none of them can handle social technology alone.

The outline of this conference suggests some of the future challenges which cry out for a solution. Can progress toward these solutions be accelerated by a more directed effort or by concentration of more scientific resources? I can comment on some possibilities:

1. A cure for certain critical diseases; for example, cancer and heart disease.

The progress in cancer research has been very impressive in the areas of diagnosis and treatment. We know much more about the causes, characteristics, genetic and biochemical factors, the possible role of viruses, etc. Still, a real solution eludes us. It is unpredictable when the pieces will fall together—it could be soon or it could take a long time. Cancer research is typically a field where Federal support is necessary. Some of the basic and applied research does not fit too well into the research structure of the pharmaceutical corporations

(which are still quite active in this field). But it is highly important that cancer research be considered long range and that pressures for quick results, or worse, sensational results be avoided. After the practical failure to solve the problem by random screening, our best opportunity lies in fundamental research and understanding. Forcing of technology does not appear appropriate in this instance.

The various treatments of cardiovascular diseases are in a state of flux and exciting developments seem likely. Great progress has been made. In treatment with drugs, the introduction of a safe diuretic (chlorothiazide) a decade ago has changed a major part of the therapy of arterial hypertension. Other recent possibilities of drug treatment of hypertension have made encouraging progress. Still most of these types of treatment are palliative; they deal with some of the symptoms of hypertension successfully without eliminating the cause. Fundamental research, therefore, remains more necessary than ever. This is particularly true in the field of atherosclerosis. Given the nature of research in this field, both the Federal Government and industry have to devote substantial energy to this problem.

Progress in the exciting field of transplants (artificial or natural) is in a period of acceleration. As it falls outside my competence, I can only stress here my hope that the problems presented by this type of treatment be recognized in the broader context. Transplantations create a set of medicoethical problems (including the right of the individual to die) of first magnitude. It is not too early for government to participate intensively in study, discussion, and regulation of these social and ethical questions.

2. Improvement and rationalization of systems of medical care, from a systems viewpoint, does not present a choice; it has become a necessity. It is necessary since medical care can thus be radically improved; moreover, if this is not done, the cost of medical care will become prohibitive. One should not underestimate the countervailing forces in the trend toward rationalization. One would hope that some of the essentials of the old system can be preserved, if necessary in other forms; e.g., the highly important function of doctor-patient relationship in the healing process. Healing is indeed a highly complex process in which sophisticated techniques and technological advances form only a part, while psychological factors are often dominant.

3. Alleviation of the world food shortage.

Again, the deployment of available technology in a systems approach could enhance world food production immensely. (An example will be given under the section on "Technology and Underdeveloped Countries.")

Moreover, new approaches (lysine enrichment, single cell sources, petro-chemical fermentation, marine resources) can change the picture. The realization of these opportunities is not so much technical, but politico-economical (with important overtones of social acceptance as regards palatability and dietary restrictions).

4. Alleviation of the world population problem.

The present, nonoptimal technology in the contraceptive field could, if applied, moderate population growth to economically justified levels. Improved technology (much of it well along the way from invention to marketable—or usable—technology) will be available. In this case it is unnecessary to reemphasize that political, sociological,

religious, and, above all, organizational breakthroughs have to be made to achieve the objectives.

The horrible dangers of population explosion are not only misery, starvation, and disease, but also much more crowded conditions of existence, which create a whole set of menacing consequences, psychological as well as physical. Accelerated treatment of this problem is mandatory: there is very little time.

5. Exploiting education's full potential.

Education—better, more efficient, more nearly totally participative—is our best long-range opportunity. It is highly important that new techniques—especially the application of the interplay between electronic devices and deeper insights into the learning process be developed. Here too, new technology is on its way. I sincerely think that this new, still largely experimental development makes it possible to leapfrog to a new system of education which will be a qualitative improvement and will make possible mass education that will help move toward realizing the fullest intellectual potential of the student.

THE TRANSFER OF TECHNOLOGY

a. Basic issues

In themselves, geographic differences in the production of technology are natural. If transfer through the industrial world takes place smoothly, such differences are even desirable. Regional differences are quite apparent within the United States. While these disparities create some problems, they are seldom of an acutely serious nature.

International transfer of marketable technology is less simple, being subject to many artificial restraints. Before World War II, the transfer of technology took place along lines which did not upset national emotions. Exports of marketable technology in the form of products usually was the first choice. Imitation or minor innovation in industrial countries often led to licensing. Regular relationships were established. The underdeveloped world, however, was still living largely within a colonial structure, which, among other things, suppressed indigenous aspirations to at least use available technology to improve local conditions.

New situations and new reactions to opportunity came in the post-World War II period. American industry certainly had great advantages on its side. The management of technological innovation had been improved immensely. The rest of the industrial world had to rebuild itself. The colonial world was certainly confronted with enormous challenges and ill equipped to meet them.

As a natural reaction to a new situation, the international corporation thrived. American corporations especially realized that optimal exploitation of innovations could be better achieved through foreign (fully or partially owned) subsidiaries rather than through the traditional first choice of licensing.

As might be expected, this has created problems. Formerly, many U.S. corporations had friendly, noncompetitive relations with their counterparts in Europe. Now, the U.S. subsidiaries have become competitors on the territory of these counterparts. Even greater complications are encountered when these international corporations enter underdeveloped countries, which have other value systems and a deep-seated fear of industrial imperialism.

The objective proof of this change in the major route for the transfer of technology is presented by the substantial increase of foreign industrial investments. Also changes in regional distribution are indicative.

While in 1958 direct investments by U.S. industry abroad were $27.4 billion, the total in 1967 (estimated) has risen to $64.8 billion. The growth of these investments has grown naturally in Canada from $9 to $19.3 billion (plus-116 percent). In Europe, however, the increase was from $4.5 to $20.2 billion (plus-350 percent). In Latin America, the growth was from $7.8 to $12.9 billion (only plus-65 percent, with some retardation in the last 3 years). The growth in the really poor world is even poorer and more erratic. These figures (Time magazine, Dec. 29, 1967) present the story in a nutshell.

For practical reasons, therefore, it is desirable to discuss the new problems in the transfer of technology (in the form of direct industrial investment by international corporations) in two parts: one dealing with transfer between industrialized states, specifically between the United States and Europe; the other, the aspects of transfer to the underdeveloped world.

b. The transfer of technology between industrialized states (with special reference on the "technostructure" or "technology" gap)

Generally speaking the technological gap is defined as a disparity in the development of marketable technology in important sectors of the economy. It is true that in very important sectors (computers, electronic circuitry) America dominates. But this is not the whole story. In many other areas there is a fair balance (see Dr. Robert Charpie, Union Carbide—who points out that there is no real gap in the technology of nuclear energy, metallurgy, and chemicals—(Deauville paper, 1967). These are certainly important sectors of the economy. In some other fields Europe is ahead: glass technology and certain optical instruments, etc.

The technological relationship between the United States and Europe is deeply influenced by discussion, emotions, and frustrations concerning the technological gap. The situation has received greater public attention since the publication of Jean-Jacques Servan-Schreiber's book "Le défi américain" (The American Challenge). The book is brilliantly written (notwithstanding what seems to me a somewhat uncritical use of many statistics) its message is often very much to the point. While the suggestion of an "economic satellization" of Europe seems exaggerated, the political and cultural questions raised are at least debatable. It makes sense, therefore, to put the gap into perspective and debunk some of the fallacies and exaggerations about it.

The fact that the United States dominates such very important fields as computers and electronic circuitry causes worry. Add to this the fact that the U.S. corporations are very often superior in organization and marketing, and one can understand Europe's outspoken misgivings about the technological gap. Moreover the gap seems to widen due to a complex combination of factors.

During the discussion of "development of marketable technology" the primary role of management was established. Many analysts have come to call the disparity a management gap. But many other factors are involved. Even management itself is the result of a national

attitude. When one defines "technostructure" as the total set of factors which influence the development of usable technology, the term "technostructure" gap might be the more appropriate one.

Indeed, American management has a competitive edge. Its integrated planning is often superior, its quality continues to increase (naturally some large European firms are on the same level, but there is broad agreement that at the middle-size level there is a qualitative difference). Education resources available for management are just growing from infancy to more mature levels, their added impact will be felt later.

A second factor advantageous for the U.S. international corporation is its size as reflected in the need for critical mass to conduct sophisticated research, in financial resources (not in the least its self-financing potential), in flexibility, and in fast adaptive reactions.

Also working to the advantage of American firms is a psychological asset: greater courage to delegate authority, when compared with their European counterparts.

Mobility and chances of promotion inside U.S. corporations, based on ability and drive, contribute strongly to the motiviation of young managers and researchers. Very important also is the mobility of this group between companies, government, and universities. The mobility gap in Europe is only slowly being cured.

Europe has had its fair share of inventions, but it has often failed to transform them into marketable technology. One explanation is that American management is very resolute in pressing the execution of the transformational phase; the lag between invention and marketable product has to be shortened if leadership is to be maintained. Holography (a realistic three-dimensional photography from which many other innovations are evolving) was discovered by Prof. Dennis Gabor in London. But its transformation into its usable potentials has been pursued most fiercely in the United States. One example out of many. And again it is worth noting that European companies often do research on a level well below the critical mass needed for success.

The number of able technologists available in America is about 2.5 to 3 times as large as in Europe. This disparity reflects an educational system in Europe where excellence in small groups is preferred to mass education. A massive pruning often excludes just those people, who, with proper training, could be important in carrying forward the arduous process through which a basic invention becomes a marketable product. This sorry state might have its cause in the rather low social acceptance and the underpayment of technologists (especially in Great Britain). An educational system is necessarily a mirror of the society it serves and it stresses what that society finds important. So a mere change of curriculums will not produce results, unless it is a real reflection of a change of attitudes toward technology. The present attitude of European society is the main cause of the "brain drain." As this transfer of human resources moves from industrial countries to the United States, it is to our great advantage, and steps should not be taken against it by the United States.

There is one major frustration that the Europeans have created for themselves. Already in 1965 Prof. C. P. Kindleberger of MIT pointed out that the American international corporation took optimum advantage of the Common Market structure. It set up an integrated network of subsidiaries, complemented its structure by clever acquisitions

and built in great flexibility. Due to lack of progress toward certain critical aspects of harmonization—especially the lack of a European company law—mergers between European firms for all practical purposes take place only through acquisition of one national firm by the other.

The present stagnation in the Common Market does not portend well for a breakthrough. It will even stimulate national mergers, which might kindle parochial nationlism. Europe needs, on the contrary, a politico-economical structure of European size, not a simple addition of the economies of the existing nation-states. Imitations such as a technological pool (Wilson; Fanfani) are palliatives. Servan-Schreiber is right in his admonition that Europe should define its technological goals and focus its efforts carefully on them, and effect programs which go to the core of the problem and create the changes which are needed.

I do not believe that the cries that Europe is becoming satellized through the economic power of the American giant corporations are warranted. Although their investments and influence are growing, their power inside a nation-state is limited, and the absolute level of direct investment ($20 billion) is in reality quite modest. Allowance must be made for the dynamic nature of the relationship. The very fact of the studies, discussion, and high political interest at this early stage gives encouragement that a sense of proportion and balance should prevail. For the future it is important that discussion and analysis of the technostructure gap be factual and constructive. The efforts in the OECD to study the quantitative and qualitative aspects are well underway and will be elucidative. A new conference of the Atlantic Council on the subject is planned for mid-1968.

One aspect deserves special treatment, since it is so largely political: the computer gap. As long as modern computer technology is freely purchasable, the manager or the technologist does not worry. The politician knows, however, that computer technology holds the key to modern technology and perhaps even the power of the modern state. He fears that at critical moments new computer technology might be withheld. This happened in France a few years ago when an export permit was denied by the U.S. Government for certain equipment needed for the French atomic energy program. This political decision by the United States had unfortunate repercussions: by dramatizing the dependence of certain aspects of French defense and technical development programs on the United States, it blew the technological gap idea out of all proportion.

I predict that Europe will be resilient in keeping the technostructure gap manageable. Many American techniques, including management, will be emulated because of their demonstrated effectiveness. A modus vivendi will be found for the optimal functioning of international corporations in the European nation-states. Europe's chief obstacle is the stagnation of the movement toward supranational economic integration. Whether West Europe emerges as an entity or will remain a group of separate nation-states (limited to some opportunistic economic integration) cannot be predicted with certainty today.

In any event, the United States should strive to maintain its technological lead: here lies its protection for a favorable industrial balance of payments. This position is an essential for the continued exercise of our functions as a world power.

Canada is a special situation—a nation with separate traditions, but with most of its inhabitants living in a narrow zone bordering the United States. U.S. industrial investment is very heavy (over 41 percent of the total). This causes real problems, which, however, are still manageable. Still it points to a lesson: economic interdependence, even if it means dependence to a larger degree, does not necessarily lead to national political dependence. Canada remains a sovereign nation-state.

The case of Japan should be mentioned: in the sectors where Europe has problems, Japan can proudly claim to hold its own. In some way, the Japanese case is rather unique: aggressive management, hard-working labor, change from low-class mass production into quality achievements, all well protected by the Ministry of International Trade and Industry (MITI). Moreover, Japan is itself advanced in the fundamental sciences covering electronic developments. Part of the examples are transferable: daring management and hard work. There is not much of the "I'm all right, Jack" attitude in Japan. On the other hand, the more Japan becomes an advanced technological power, the more it will have to liberalize its protectionist policy. But the Nation will meet this challenge from a position of strength.

c. Technology and the underdeveloped world

It would make sense if the effort and emotions now directed to the technostructure gap between the relatively rich, the United States and Europe, were applied to the really desperate problem of the ever-widening gap between rich and poor nations. Once—specifically after the Marshall plan was successful—it was hoped that an infusion of monetary aid on a government-to-government basis would help build an infrastructure that would permit an intensified transfer of technology through the private sector. This would have led to self-sustaining growth, hopefully of a type most appropriate to the country in question.

There have been successes. GNP's have increased in the aggregate, but taken as a whole, expectations have not been met. Disappointments and frustrations are now the order of the day. Yet, the recognition that the problem is much more complex than had been anticipated is a healthy development. The pertinent recognition that the solution extends beyond the realm of technology explains a paradox: while much technology is available to promote substantial growth for the underdeveloped countries, attempts to apply it have not lived up to expectations. The answer lies in the attitudes and traditions of both the industrialized countries and the underdeveloped ones themselves. (See, for a brilliant analysis, Theodore Geiger's book "The Conflicted Relationship," 1967.)

As Harvard's John Montgomery has recently pointed out (International Development, March 1967), planned technological invention in a less-developed nation must take into account the strong interplay of noneconomic factors. He lists three: how well the imported technology fits into the traditions upon which it impinges; the communication by which the new element is diffused; the capability of the recipient nation to implement the required progress of action. To quote Professor Montgomery: "Each of these three factors has been neglected in toto in the blind assumption that technology, like dollars, is a universal medium of exchange."

As a consequence of misunderstanding, a vicious circle has developed: the richer countries demand that the poorer ones adopt a number of economic policies in order to use outside aid efficiently. Yet such policies can often only be adopted by the poor countries in a later stage of development. This vicious circle can only be broken by the rich countries. At the present time they do not show many signs of a real political will or inclination to do so.

Economically the weak dynamism of development is distinguished basically as a defective process of capital formation. Capital formation is here no economist's abstraction: it is the basic investment process through which savings are transformed into instruments of production. Not only are local savings inadequate, but substantial stoppage occurs in that such savings are often channeled to more developed areas for investment in the industrialized world. Anyway, what is left of present local savings is completely periled by the service debt.

Politically, there is no better way to characterize the stagnation than in the terms of the simple and ubiquitously evident lack of political will (the term is used to mean the resolution by a government, as exemplified by its actions, to carry out programs to achieve national goals). The rich countries recognize the importance of complementing the efforts of the poor ones—for altruistic or strategic reasons. But the long-range character of the process and the present disappointments work against more magnanimous appropriations. Behavioral patterns as reflected in the acts of some underdeveloped countries do not help either, but they can better be excused. The whole matter is leading to a confrontation at the UNCTAD meeting this year.

Some general steps can be taken by the industrialized world without much sacrifice (preferences for manufactured goods; some commodity agreements; some sort of fund protecting specific underdeveloped countries against uncontrolled deterioration of trade—all complex mechanisms—but technically possible). They would at least demonstrate a political will by the rich countries to attempt to break the vicious circle.

The international corporation certainly offers great opportunities for the transfer of technology to the underdeveloped world. But it is at the same time a frightening phenomenon for them: the personification of economic imperialism.

We have to return here to a basic fact. The capacity of the poor countries to make meaningful inventions themselves is minimal. Their capability to change inventions into useful technology is extremely limited. In that sense they are dependent on the industrialized world. Still, such a technological dependence can be recognized and accepted without loss of their precarious independence.

But now other values come in. Motivations for economic growth may be totally different than those of the highly developed nations. For instance, in large areas of Africa, regional concentrations of tribalism prevail (and, why not?).

In two areas the rich nations could demonstrate greater concern for those less developed technologically. Education is an essential precondition. Most needed is education on the high school level, and this is where funds would be of the greatest value. In this light, the nonfunding of the International Education Act is a clear symptom of lack of political will. Some useful steps might also be taken to limit or reverse the brain drain of technologists from the underdeveloped countries. It is a serious loss of lifeblood.

On the positive side, the organizers of the Franklin books programs are pursuing an imaginative effort to break the vicious circle by establishing local book publishing industries and training the needed personnel. Their acceptance in underdeveloped countries proves that methods can be designed that overcome fears. Another example is presented by a working group under the auspices of the Business Council for International Understanding (BCIU) which has developed (through a systems approach with the help of computers) an agro-model, which could make India self-sufficient in feed-grain production in the early seventies.

Besides the normal scope of steps which could stimulate action of the international corporations in the poorer part of the world (tax incentives, investments guarantees, etc.) new possibilities lie in systems approaches in which many parties (governments, financial institutions, international and local corporations) cooperate. Agreements for such collaboration could take many forms: consortia, management contracts, public enterprises gradually to be moved to the private sector, etc.

Some successful mixed approaches have taken place. Present efforts in the fertilizer industry in India, for example (how frustrating they often have been for parties speaking a different language, not so much literally as figuratively) show signs of success. New ways have to be found. Some are being explored by the refreshing FAO–Industrial Committee—a cooperation between FAO and technology oriented industrial corporations.

It might be that a pure technological demonstration conference could be helpful. It would present methods on how large problems of industrialization—especially in the agricultural field—could be solved and how this could lead to further developments; it could suggest which available technologies could be adapted for economic growth at a certain stage. By keeping such a conference purely technical the interest of the underdeveloped countries could be whetted and it might create enthusiasm in the richer countries.

We should not let the magnitude of this challenge frighten us to retreat from engagement into the comfort of our own society's beguiling affluence. Technology can be an instrument of mutual progress and mutual understanding for all nations. In a hostile and dangerous world, to hoard it selfishly or to use it for a lesser purpose would be unworthy of the nation that we are.

OBSERVATIONS ON THE DOLLAR

By

GAYLORD FREEMAN

Chairman

THE FIRST NATIONAL BANK OF CHICAGO

May 14, 1971

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I. WE HAVE A PROBLEM -- MORE DOLLAR CLAIMS OUTSTANDING THAN WE CAN PAY WITH GOLD -- OR GOODS

Over the past quarter century we have sent more than $300 billion abroad in purchases, investments, tourism, aid and other expenditures. Some $45 billion of that remains abroad. If the foreigners would use those dollars to buy our goods, our business would boom, employment would be high, and our nation would prosper. But they are not using those dollars to buy our goods and the consequent glut of dollars has moved into their central banks with resultant inflationary pressures on their economies. They resent this and blame the United States for upsetting their domestic economies.

Why is it that they do not use the dollars to buy our goods? Because our goods are too high priced. The foreigner can exchange his dollars for another currency which will buy more foreign goods than the dollar will buy in American goods. Under these circumstances the United States has three alternatives.

We can:

1. Reduce our foreign expenditures (curtail imports, tourism, foreign travel, etc., reduce or eliminate foreign aid, military assistance, and our foreign expenditures for the defense of the free world, or some significant part thereof);

2. Reduce our costs and prices in dollars; or

3. Reduce our costs and prices in terms of other currencies (by reducing the parity of the dollar in relation to other currencies).

Perhaps there is a fourth alternative -- to do nothing. That escape is attractive because none of the foregoing three alternatives is very welcome.

Alternative 1. Although there may be room for considerable reduction in our military expenditures -- at least those that are partially for the benefit of other countries, especially NATO and Japan, our country is not disposed to pursue the first alternative at this time.

Alternative 2. To reduce our dollar costs is to challenge the power of organized labor.

Alternative 3. To reduce our costs in terms of other currencies is to reduce, and in some instances, eliminate, the surpluses now enjoyed by the other principal trading nations.

As the aggregate international payments must balance, it is obvious that if we eliminate our deficit (by any of the three means) it is inevitable that the surpluses of some other nation will be converted into a deficit. Thus, despite their exhortations to do so, the reduction of our deficit may antagonize certain of the other countries now in surplus. If they seek to do so, they can thwart our purpose by further devaluations of their own currencies.

Thus, to achieve any lasting near-balance in world payments, it is imperative that we reach some agreement with our principal trading partners, both as to realistic parities and as to payment balances.

A. The Development of the Problem

For more than a century after the creation of our country, we Americans worked hard and produced large quantities of goods for ourselves and, as a consequence, our standard of living improved. As our large domestic market gradually allowed us to mass-produce goods, our prices were reasonably low, and we sold an increasing volume of such goods abroad. We bought things from foreign countries too, but not as much as we sold to them, partly because, with smaller markets, the foreign nations could not produce as cheaply as we. As a consequence, for most of the past century we sold abroad more than we bought from abroad -- that is, we had a consistent "balance of trade" surplus -- and it was one of significant proportions.

But after World War II we increased our expenditures abroad. We bought more goods but, in addition, we began to spend enormous sums of dollars abroad for other purposes.

Under the Marshall Plan and other programs, we gave economic assistance to many countries.

To bolster friendly governments, we gave military aid.

Our people, feeling rich, took vacations abroad.

Our companies saw opportunities to build plants abroad.

As other shipping lines buy their ships at lower cost than we and pay their seamen less, their freight rates were lower and so we used foreign ships.

We bought lots of insurance abroad because foreign underwriters have quoted lower prices and covered more risks.

That is all right. We can't be best at everything.

So what's the problem?

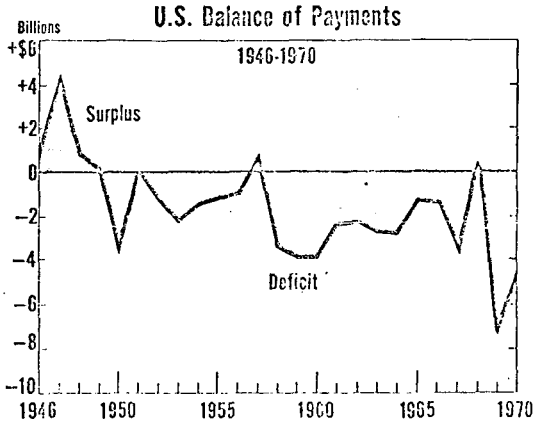
1. The Increase in Our Dollar Liabilities

It is hard to see unless we begin to look at some numbers. From the end of the war through 1970:

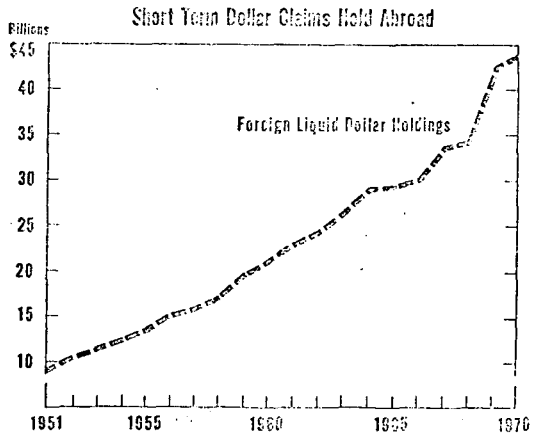
We gave away and/or loaned without repayment about in economic assistance.	$85 billion
Our military assistance programs added an additional to our foreign expenditures.	$40 billion
Our tourists spent an aggregate of in foreign travel.	$38 billion
Our total private foreign investments rose by	$90 billion
Other "invisibles," insurance, shipping, etc., added another	$50 billion
For a total of about	$300 billion

Three hundred billion dollars is quite a lot of money, even for the United States. In fact, it is a great deal more than our trade surplus brought in.

So, instead of bringing home additional funds, we sent far more dollars abroad, and we did this year after year. In fact, despite our trade surplus, we had a deficit in our overall payments -- which we call our "balance of payments" -- in 19 out of the last 21 years.



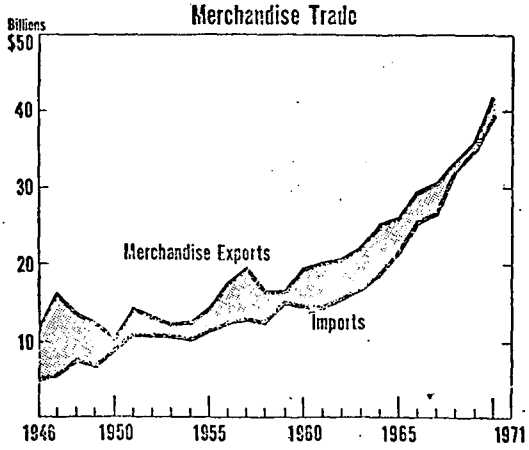
As a consequence of these repeated deficits in our balance of payments, foreigners began to accumulate additional dollars year after year.



These dollar claims held abroad increased from $7 billion in 1950 to $43 billion at the end of 1970. One country, Germany, has had an increase from less than $1 billion in 1950 to approximately $3 billion in 1960 and to a reported $12 billion at present. At the close of 1970, Canada had about $4 billion and Japan about $5 billion.

The trouble is that the foreigners don't want to use enough of their dollars to buy our products, because our prices are too high. They may buy their wheat from Canada at a lower price, their machine tools from Germany and their cameras from Japan. They do buy some computers and airplanes from us -- but not enough to use up their accumulated dollars.

Nevertheless, the United States need not hang its head. We still have our traditional surplus on our balance of trade, although the $2.2 billion of last year was less than half our level before our prices and costs began to move upward so rapidly in 1965.



Between 1965 and 1970, our imports rose from $21.5 to $39.9 billion, an increase of 85 per cent. Our once respectable merchandise trade surplus has dwindled.

We also have a surplus on our over-all international investment accounts -- of $3.5 billion in 1970, as our net foreign investment earnings of $6 billion more than offset our net outflows for new investments. All in all, therefore, the private sector of our economy has done quite well with a still significant surplus. But this has been more than offset by the expenditures of our government for foreign aid, for the defense and security of NATO and Japan, and by our expenditures in Vietnam. If these expenditures are to be maintained, they will have to be covered by our trade and investment earnings surplus. But we have not been able to do that.

U. S. BALANCE OF PAYMENTS – 1970
(billions of dollars)

	Receipts	Expenditures	Balance
Merchandise	42.0	39.8	2.2
Travel	2.3	3.9	–1.6
Shipping, insurance, and other invisibles	6.0	7.0	–1.0
Income on investments	11.1	5.1	6.0
Military transactions	1.5	4.8	–3.3
Foreign aid	1.7	4.9	–3.2
Foreign investment	6.1	8.6	–2.5
Unrecorded outflow of funds, net	-	1.3	–1.3
Total	70.7	75.4	
Deficit on liquidity basis, excluding allocation of SDRs			–4.7

As measured in our balance of payments accounts, our foreign aid and military expenditures totaled $6.5 billion,

leaving an over-all payments deficit of $4.7 billion (after excluding our allocation of SDRs). A reduction in our aid and military expenditures would help moderate the rise in our cost structure. With that in mind, it would be appropriate for us to ask the other nations, particularly Germany and Japan, for whom we have done so much since the end of the war, to bear a higher proportion of world defense and aid expenditures.

Thus, you can see that the foreigners do not spend anywhere near all of their dollars to buy our goods but, on the contrary, the German auto maker, the French vintner, the country receiving military assistance, get more and more dollars. They have more dollars than they want, so they have taken those dollars to their local banks and exchanged them for their own currency or for Canadian dollars or yen or Deutsche marks.

It is this failure of the foreigners to use their dollars to buy our goods (because they are priced too high in relation to goods from other countries) that is the heart of our problem. Present levels of aid, investments, invisibles and imports would all be sustainable if the dollars so moving abroad were turned around and sent back to the United States for goods we produce -- but they are not. Our prices are too high. Thus the foreigners have accumulated more dollars than they want.

For the past several years this fact was obscured because the foreign commercial banks were quite willing to accept the dollars because they knew that they could (whenever they wanted to) take those dollars to their central bank and get their own or other currencies at a fixed price. Besides that, the commercial

banks were able to lend out those dollars at higher rates than they could lend their own currencies. This was due to a restricted supply of funds and interest rate regulations in the United States which caused Americans to borrow a lot of these dollars owned in Europe (hence called "Eurodollars").

However, funds are now available in the United States, and at lower interest rates than in Europe. Americans have repaid some of their Eurodollar borrowings, Eurodollar interest rates have dropped, so the foreign commercial banks no longer want to hold as many dollars. As a consequence, they take the dollars to their central banks and obtain other currencies in exchange.

2. Our Promise to Pay in Gold

In 1945, the central banks agreed that they would buy and sell currencies at fixed parities (or exchange rates) in relation to the dollar and to gold.

Hence, the foreign central banks have accepted the dollars from their commercial banks, both because of that earlier agreement and also because the dollar is the principal international currency. Perhaps even more important, the foreign central banks had been assured* by our government that the Treasury would buy those dollars for gold at a fixed price (of $35 per ounce of gold) any time the central banks so desired.

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* By the Gold Exchange Act of 1934.

In view of our promise to convert dollars into gold at a fixed price, each such central bank was quite willing to accept dollars in settlement of transactions with other nations. Indeed, since not much gold was being mined, the foreign central banks were glad to have an increasing volume of dollars to finance the rapid growth in international trade. Thus for years the accumulation of dollars abroad was welcomed. It overcame the "dollar gap" of the forties and early fifties and created little concern until quite recently.

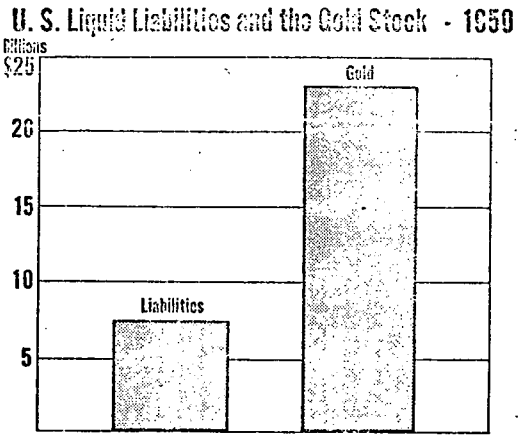
So what has changed?

The one thing that always makes a creditor uneasy -- uncertainty as to whether the debtor can pay.

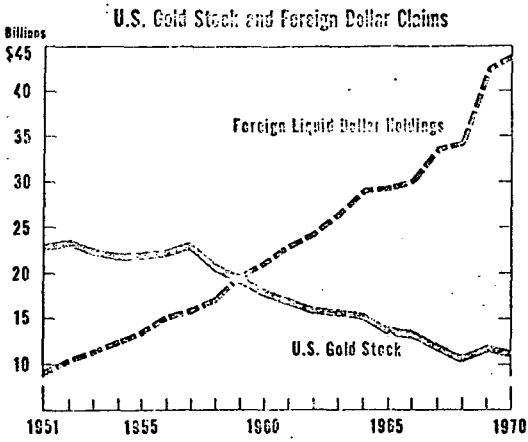
3. Our Inability to Pay

But how can anyone question the ability of the great United States to pay? Is there any question of its honesty or its good intentions? No, but the United States has said that it would redeem all of those $43 billion of dollar claims (or so much thereof as are presented by the foreign central banks) and pay in gold at the fixed price of $35 an ounce.

Twenty years ago we could easily do so for we had $23 billion of gold to pay a modest $7 billion in short-term dollar claims.



But in the last twenty years, while we were spending all of those dollars abroad and were also using our gold to pay for some of our deficits, our gold supply has diminished. As the claims against us have risen, our ability to pay has declined.



As of December, 1970, we had $43 billion of short-term claims outstanding and only $11.1 billion of gold with which to meet those claims.

Our situation may not be quite so bad as that sounds. We have some other assets besides our gold -- and short-term "swaps" or borrowings.

At the end of 1970 we had --

	$600 million of convertible currencies
	$1.9 billion of IMF drawing rights
	$900 million of SDR's, as well as that
	$11.1 billion of gold
for a total of	$14.5 billion.

But still that is only about one-third of the short-term claims held abroad.

Even so, the Treasury isn't required to pay gold for all of that $43 billion of foreign-held claims. They have only undertaken to pay gold for such amounts as are presented to us by the central banks.

As of December, 1970, the foreign central banks held only $20.1 billion. That is not $43 billion, but it is more than the $14.5 billion we have in gold, convertible currencies and drawing rights all put together. We can't even meet those claims if they are presented by the foreign central banks.

Our problem is simply that foreigners have more dollars than we can redeem in gold or goods -- at present prices. As a consequence they do not put as high a value on the dollar as they did -- nor do they put as high a value on the dollar as they put on the number of Deutsche marks or yen or Swiss francs for which they could exchange the dollar at recent rates. Thus they turn their dollars into the central banks which now have more dollars than they want.

4. Is the Problem Really Serious?

(a) The Foreign Central Banks May Not Ask Us to Pay.

After all, the other nations are more interested in international trade than are we. For most foreign countries international trade constitutes a far larger part of their total

activity than is the case in our country. To carry on this very extensive and rapidly growing trade between nations requires a medium of payment, a currency that is both --

(i) universally acceptable, and

(ii) outstanding in an adequate amount.

No currency other than the dollar quite meets those two requirements. Sterling did for several centuries, but in view of the deterioration in Britain's position, the loss of its Colonies, and its several successive devaluations, sterling, though still a respectable international currency, is not as desirable as the dollar.

The Deutsche mark and the yen are stronger than the dollar, perhaps under-valued and universally acceptable, but they are not available in anywhere near sufficient quantity to finance world trade. Thus, with no other entirely acceptable alternative available, the world's central banks don't want to see the dollar abandoned as a world currency. At least not until there is a better alternative currency in adequate supply. Ten years from now the Common Market countries may have a common currency which meets the two requirements and it may serve as a second reserve currency or even displace the dollar as the dollar took the place of sterling. But such a common currency will not develop overnight.

So, in the meantime, what can the central banks do?

Throughout 1969 and 1970 when the commercial banks were holding the great bulk of the foreign-held short-term dollar claims and enjoying high interest rates, which they received thereon, the foreign central banks were relatively content to hold their dollars -- and to get a nice return on their dollar claims, too. At the same time they urged the United States to "get its house in order," that is, to slow the rise in our prices (particularly in the export prices of our manufactured goods), increase our exports, and achieve a balance in our payments. The foreign nations, and especially France, may also have enjoyed criticizing us a little in view of the fact that until a few years before we had been quite critical of those countries whose loose domestic policies had resulted in the necessity for their devaluations. But beyond their sanctimonious speeches at the annual meetings of the IMF, they were not willing to do very much. In fact, although they urged us to get our payments into surplus, none of them offered to turn their own surpluses into deficits. However, Germany now has on three occasions permitted its currency to rise in relation to the dollar which has hurt its exports and helped ours.

On the most recent of these occasions earlier this month, Germany, after ceasing to support the dollar at the official rate of $1.00 to 3.66 Deutsche marks, sought to achieve an agreement with the other Common Market countries whereby they would all adjust their currencies in relation to the dollar. This might have relieved -- temporarily -- some of the existing stresses and might

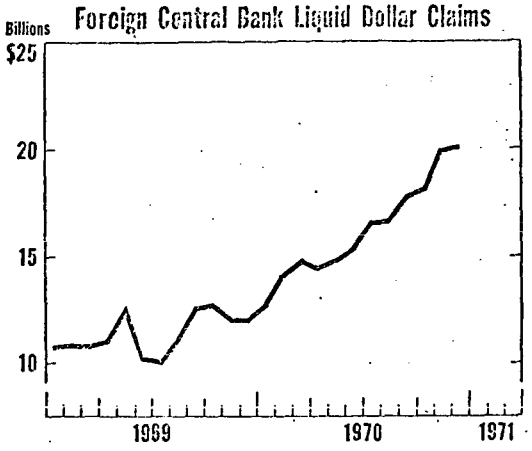
have made U.S. dollar prices more competitive in world markets. But (aside from Switzerland and Austria which are not members of the Common Market) only Belgium and Holland were willing to cooperate, and Belgium only to a limited extent.

Thus, the first of a probable series of crises has passed. And as Paul Samuelson observed, "It was no economic Pearl Harbor."

So why worry?

Well, we might worry because far from "getting our house in order," our position continues to deteriorate. Our balance of payments deficit (excluding our receipts of SDRs) was $4.7 billion in 1970; the foreign held short-term claims increased by about $2 billion in 1970. Our supply of gold, hard currencies and drawing rights decreased $2.5 billion in 1970, and the situation continues to deteriorate. We are not using our time to get our house in order. The situation grows worse by the month!

Second, we might worrry because our domestic interest rates have come down. This has occurred because -- for domestic reasons -- we have shifted our monetary policy from one of restraint to one of greater ease. Perhaps the decline is only temporary, but in the interim there is less demand for Eurodollars abroad. Consequently, more and more foreign commercial banks have been turning their dollars into the central banks, and at a staggering rate.



On three days in early April some $2 billion had to be absorbed by the Bundesbank, and on May 4 and 5 another $2.2 billion. This triggered Germany's determination to float the mark. After some brief interval, it is likely that Germany will stop floating the mark and fix a new rate. Since that German action, both that country and Belgium have attempted to discourage any further movement of foreign owned funds into their countries (by prohibiting the payment of interest thereon). Other restrictions on capital movements are likely to follow.

Third, we might worry because as dollars are presented to a foreign central bank it has to issue its currency in exchange. This increase in its money supply may create inflationary pressures within its country -- perhaps at a time when this directly thwarts

its intended anti-inflationary policy. This was the case in the recent inflows into Germany and explains why the foreign central banks deeply resent such inflows. They feel that the United States is creating the problem for them -- and not assuming any responsibility for its solution.

Fourth, and most important, the temporary "relief" accorded the dollar by the floating of the mark and the modest changes in the other currencies will only tend to reinforce the conviction of our people that they can devote their attention exclusively to domestic problems. Statements that the recent disturbance was a German problem, thereby apparently denying any responsibility on our part, is, unless it was merely a trading gambit, the expression of a truly disturbing point of view. The present crisis is not due to short-term speculative swings seeking arbitrage. On the contrary, it is an acceleration in the movement away from the dollar that has been going on for several years and gaining velocity over the past few months. The professed attitude of the Administration (which would appear to be that of a detached observer) appears to be one of relief that the crisis has passed. Instead of taking the matter seriously and attempting to regain competitive prices for our goods around the world, it suggests that they will continue to stimulate the economy for short-range domestic reasons -- either unmindful of, or unwilling to acknowledge that, the inevitable result of this stimulation will be more rapid increases in our domestic prices and a further worsening in our competitive position in world markets. (It is to be hoped that this is merely a pose to distract the world from still secret efforts to achieve a multi-national agreement on new parities.)

Thus, though we may feel relieved by the passage of this crisis, the longer-term result may be merely to exacerbate an already serious problem -- prices out of line with world markets and a further destruction in foreign confidence in the dollar.

Fifth, looking even further ahead, our own unwillingness to attack the underlying issue of "overpriced U.S. goods" and consequently our postponement of corrective action, may accelerate the development of the Common Market's common currency. The prospect of such an acceptable world currency does not concern us today, but it may on some tomorrow. If it becomes the world's number one currency, then the United States corporation desiring to invest abroad will find itself in the position of the European corporation today. To invest, it would have to borrow a foreign currency which neither it nor its home banks can generate at will. Thus, our corporations will be severely handicapped, just as British and other foreign corporations, which cannot use their domestic currencies abroad, find themselves handicapped today.

To me it is tragic that the United States, the richest country in the world, is a debtor which is unable to meet the demands which at any moment may be made against it. It is almost equally unfortunate that our government seems to be unwilling to give the problem's solution any priority.

Many observers continue to say, "Don't be concerned. The United States is the banker to the world and, like any other banker, it can't afford to keep itself so liquid that it could pay all of its deposits at any one moment. Besides, it doesn't need to, since the depositors will not all seek payment at any one time."

But that is far from an apt analogy. When an ordinary commercial bank is faced with withdrawals in excess of its cash and quickly marketable securities, it can go to its central bank for liquidity. But there is no equivalent place for the U. S. government or its central bank to go. Furthermore, the ordinary commercial bank has total assets far in excess of its liabilities. Beyond its liquid assets, it has extensive longer-term assets, notes and securities which provide the base for its borrowing of cash from its central bank. But the U. S. Treasury has no similar assets to support the dollar.

Thus, today if the foreign central banks should press for payment, our Treasury would be unable to pay its debts as they are presented.

So today we cannot redeem our outstanding obligations. In that sense, our nation is insolvent. As Gottfried Haberler has suggested in a recent study:

> "To put it bluntly, it is now fairly generally realized that....the dollar is de facto inconvertible into gold, at least for large sums.... Foreign central banks cannot convert large sums of dollars into gold....as France did under DeGaulle in the 1960's."*

We avoid the humiliation of presentation and confessed inability to pay, only through the forbearance of our creditors -- the foreign central banks.

Economists at one end of the spectrum argue that the growing discrepancy between the U. S. gold reserves and the volume of foreign-held dollar liabilities will eventually undermine confidence in the dollar and lead to a crisis. But they differ as to the solution. Some, such as Jacques Rueff, for example, want to go back to the gold standard, after doubling or tripling the price of gold. Others, such as Robert Triffin, want to avert the danger by making the IMF a real world central bank, a lender of last resort with broad money-creating powers.

Economists at the other end of the spectrum, while conceding the deterioration in the competitive position of the United States, still contend that the other nations have become so dependent upon the dollar as to have little choice in the matter. They may either go on accumulating unwanted dollars or alter their own policies, reducing their own payments surplus (and incidentally our deficit in the process) by appreciating their exchange rates, by reducing their trade barriers to our exports or perhaps even by assuming a greater portion of the foreign aid and defense expenditures

* Gottfried Haberler and Thomas D. Willett, A Strategy for U. S. Balance of Payments Policy, American Enterprise Institute for Public Policy Research, February, 1971.

which the United States now bears. Thus, economists of this view argue that we should not be overly concerned with our payments deficit.

I hardly need point out, however, that our creditors are not inclined to blame themselves for our situation. Some feel that they adopted the domestic disciplines required to prevent their own prices from rising and should not now pay the price for our unwillingness to do the same. As a consequence, they are unwilling to revalue their currency upward (and, therefore, lose exports and create a deficit in their payments balance) just to help us -- at least not until we show some willingness to take the steps required to solve our own problem.

(b) Is the Problem Just a Temporary One?

Some argue that the problem is temporary and suggest it is already improving. They point out that wages rose faster in Japan last year than in the United States. It is true that the average wage in the steel industry in Japan went up about 17 per cent as against an increase of only 5.6 per cent for the steelworker here.

But the Japanese wage went up from $1.54 per hour to about $1.80 per hour, an hourly increase of only 26¢, whereas our workers' wage went up from $5.38 per hour to $5.68 per hour, an increase of 30¢. Whose wage went up the most? Which nation became less competitive in its costs by virtue of those increases?

Some writers say that high wage increases in the United States (an average of 12 per cent in the first year of the new contracts entered into in 1970) are not really significant in view of the fact that two-thirds of the labor force is non-organized. But, as every business manager recognizes, eventually he has to match these union increases with similar increases for his office and other unorganized help.

Others argue that our dollar outflow is entirely due to the escalation of our expenditures in Vietnam. This war is so unpopular that we are tempted to blame it for every unpleasant situation. In the first place, however, our payments deficits existed long before 1965. There is no question that our military expenditures and our foreign aid constitute a severe drain on our international payments. If (i) we stopped all military spending in Vietnam and (ii) brought back all of our soldiers and sailors from Europe and the Mediterranean as well as the Far East, and (iii) halted all of our foreign aid programs throughout the world, our balance of payments would have been in surplus by at least $2 billion in 1970, although this assumes, of course, that there will be no offsetting cost increases elsewhere.

However, many respected observers do not believe that we can achieve these savings. Reduction in military expenditures in Vietnam might be offset by (i) civil expenditures and economic aid programs to hold that country together, (ii) aid to Thailand, Laos and Cambodia, and (iii) increased military expenditures in the Middle East. It is not realistic to assume that once the Vietnam War is over there will be no further tensions, no need for a continuation of present foreign military expenditures in Europe, and no need to prop up friends with economic aid. While some reduction may be achieved in these costs, it is very doubtful that the savings will be large enough to resolve the over-all payments deficit.

We have a serious dollar problem, and it is not suspectible of any easy or automatic solution. The problem has been building up for years -- and our national disposition has been to ignore it, and to hope it will go away. It won't! We cannot afford the fourth alternative of inaction.

B. The Underlying Cause of Our Problem

What has brought about this problem?

What happened? We were rich and powerful and generous and respected, and somehow all of a sudden we find that our credit has deteriorated. We are considered "slow-pay," perhaps insolvent, a debtor existing by the sufferance of creditors on whom we were showering our largesse just a short time ago.

What has happened to change all this?

1. We Have Great Assets

We had a great country. We still do. But what are the sources of its strength?

There are several, and certainly they include:

(a) Natural resources (agricultural and mineral);

(b) An invigorating climate;

(c) Adequate capital;

(d) A productive people:

(i) Well educated;

(ii) Ingenious;

(iii) Hardworking;

(iv) Peace-loving;

(e) A large market without internal barriers.

We still have these blessings (or most of them). But the difference is that we no longer are unique in these respects.

2. But Now Other Nations Have Equal Assets

Let us examine our assets.

(a) Natural Resources

Our country is richly endowed with natural resources, and these were instrumental in our early development. We still have our great mines and our cornfields. These became even more precious as across the world the enormous increase in the raw material needs of modern industry threatened to outstrip by far the once traditional sources of supply. But, as a consequence

of this fear, vast new raw material sources have been opened up over the past two decades, and revolutionary changes in bulk and ocean shipping have made direct access to conveniently located, nearby raw material sources much less important than formerly. Any nation, such as Japan, with adequate harbors can locate industries on the coastline, thereby gaining advantageous access to raw materials. The Japanese steel industry, for example, relies almost entirely for its raw materials upon distant world market sources from whence it can bring them to its shores as cheaply as we can bring our own domestic supplies to our plants. Even the United States now imports one-third of its iron ore, more than 10 per cent of its aluminum, more than one-fifth of its petroleum and almost all of its nickel. We are indeed fortunate, but we are no longer unique in our access to raw materials.

(b) An Invigorating Climate

Our country lies in the Temperate Zone -- but then so do Western Europe, Japan, Australia and much of Russia, South America and Africa. Our climate is a blessing, but it is not unique.

(c) Adequate Capital

We have large amounts of capital -- probably adequate capital, despite our recent recourse to expensive foreign

financing which reflected inflation and higher interest rates at home. But so does Western Europe (it helped finance our earlier development and is now developing significant capital markets). Japan has lacked adequate capital, but its people are saving at almost twice the rate of our people. By sacrificing some competitive economic freedom, Japanese industry has been able to attract enough from around the world to fuel its virtual economic miracle. Moreover, as with trade, the post World War II years have added greatly to the international mobility of capital. So, the adequacy of capital is not the unique advantage to the United States that it once was.

(d) A Productive People

Our people are great.

They are literate, at least about 98 per cent are; but that compares with 99 per cent in Germany and Britain, and 98 per cent in Japan. Our traditional emphasis upon education, however, has exposed a much larger proportion of our population to some form of higher education.

Our people have ingenuity. We would like to think we have more than the other peoples of the world, though this is hardly demonstrable.

Our people are willing to work. Our workweek, which is only a rough measuring standard, has averaged between 37 and 39

hours over the past decade. In Western Germany it was 48 hours, but weekly hours worked have declined to 44. In Japan it is 49 hours.

My friends in manufacturing abroad tell me that the tempo of the worker in our factories may be better than that in England, but no better than that in France, lower than that in Germany, and considerably lower than that in Japan.

We know that our people remain peace-loving and that we have no territorial ambitions, but the fact is that in the past twenty years we have spent far more money on military campaigns than have any of the other major powers, first in Korea and now in Vietnam. Despite our people's good intentions, we have spent some 140 billion dollars in these two military campaigns which inevitably stimulate inflation and add to our costs, making exports more expensive, increasing imports and further impairing our balance of payments.

We are literate, ingenious, hard-working and peace-loving -- but do we have any unique advantages in these respects?

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(e) A Large Market Without Internal Trade Barriers

Mass production requires mass markets. We continue to enjoy a large, affluent, domestic market consisting of about 200 million people. But the population of the Common Market, within which tariffs have been removed, now totals 186 million, a total which will be greatly enlarged if the 55 million people of Britain, and the 35-40 million people of the other countries seeking membership do gain admission. The standard of living of the European countries is not up to our level, but if the present negotiations succeed, this European market would surpass ours in population and approach us more closely in terms of wealth. Similar dramatic changes are taking place in Asian markets. Japan, unable to establish its hegemony over Southeast Asia by military force, is now establishing similar control commercially -- a development in which our country has assisted. Although the Asian population has modest income compared to ours, there are more than a billion people in that market. In addition, the sustained effort to reduce tariffs and trade barriers since World War II has opened up world market possibilities to a greater degree. Thus, this once unique advantage which we have enjoyed is now common to at least two other powerful competitors.

3. Our Advantages Are No Longer Unique

The heart of our problem is two-fold.

First, in the past, the United States had unique advantages - access to raw materials, a large market, adequate capital, and industrious people. Exploiting these unique assets made us rich. It gave us the highest living standard in the world. But the fact is we no longer are unique in these all-important respects.

Second, as a nation we have not realized that these are no longer ours exclusively. But the fact is that today these advantages are possessed in significant degrees by our competitors. As a consequence, we are playing the economic game under the same advantages and handicaps as are the Western Europeans and the Japanese. No longer do we have significant advantages. They are skilled, competent and well-educated and they appear to be willing to play harder.

Moreover, the game is far more important to them. We export more than any other nation in the world, but trade accounts for only about 4 per cent of our Gross National Product and is therefore much less important to us than to our competitors. Exports from the Common Market to non-member countries are equivalent to about 12 per cent of their combined GNP. For the individual member country, however, the flourishing trade within the EEC means that total exports from the Netherlands are equivalent to about 45 per cent of GNP, Belgian exports account for about 38 per cent of GNP, and German exports for 23 per cent. Thus, they are willing to play the game a little harder.

Can we expect to continue as the champions?

II. WHAT SHOULD WE DO?

We are still king of the hill, but the top of the hill is slippery and the gang is coming up to try to topple us. So what should we do?

There is no quick solution, there is no easy solution, and there is no single solution. We are continuing to build up dollars abroad -- dollars which are not wanted because they cannot in fact be exchanged for gold -- or for goods at competitive prices. Our creditors, the dollar holders, are restive and impatient. And they are beginning to doubt that we will do better in the future.

Under these circumstances the United States has three alternatives and only three. We can:

1. Reduce our foreign expenditures, curtail imports, tourism, foreign travel, etc., reduce or eliminate foreign aid, military assistance, and the defense of the free world, or some significant part thereof;

2. Reduce our costs and prices in dollars; or

3. Reduce our costs and prices in terms of other currencies (by reducing the parity of the dollar in relation to other currencies).

None of the three alternatives is welcome. Although I believe that there is room for considerable reduction in our military expenditures -- at least those that are partially for the

benefit of other countries, especially NATO and Japan, I do not believe that our country is willing to pursue the first alternative at this time, at least to the extent required to balance our payments.

Our prices constitute the underlying problem which we must resolve if we are to maintain our position of leadership in the world. Otherwise, any other remedy would be no more than a temporary stopgap measure. In the interim, however, it would be helpful if we could somehow reassure our creditors, to make them less impatient and more inclined to wait for us to become more competitive.

Thus, we must simultaneously work on two aspects of the problem.

We must seek to become more competitive.

We must encourage our creditors to forbear while we do so.

A. We Must Re-Establish the Relative Purchasing Power of the Dollar

The dollar is not considered to be as sound as the Deutsche mark or the yen -- at the moment. But it can be made as sound if we, as a nation, establish the priorities to make it so. It is not necessary actually to balance our payments (though to do so for one or two years would certainly create confidence), nor do we have to keep our prices absolutely stable.

What we must do is to convince the rest of the world that the United States will maintain the relative purchasing power of the dollar vis-à-vis other convertible currencies into which the dollar can be converted. If a dollar will buy as much of American goods as the number of yen, into which the dollar can be converted, can buy Japanese goods, then our foreign friends will be willing to hold dollars and buy our goods. Business will be brisk, employment high, and we will benefit domestically as well as internationally. But today that is not the case.

The past few weeks have highlighted the problem. As of May first, one dollar equalled 3.66 Deutsche marks, but 3.66 Deutsche marks would buy more goods than would the dollar. So dollar holders switched their dollars into Deutsche marks -- and in such quantity that the Bundesbank stopped buying dollars -- and the mark was floated.

Thus, there are two basic alternatives. We can either --

(1) Hold down the dollar price of our goods so as to achieve a reduction in relation to the prices of others' goods, or

(2) Reduce the fixed ratio of the dollar to other currencies.

The first is the more difficult course, but is far preferable to the second course of action which offers no permanent solution. As we have seen through several recurring foreign exchange crises now, adjustment of rates alone does not solve the problem.

We can implement our first alternative but at some cost, for it would require public acceptance of restrictive governmental policies, and we first must educate the people as to the existence and importance of the problem requiring these policies.

1. We Must Acknowledge the Problem and Accept the Fact That It Is of Sufficient Importance to Warrant a High Priority Among National Goals

Basic to a solution is to give the problem serious attention. So far we haven't done so.

Too few of our government officials even understand the problem. The appointment of an Assistant to the President for International Economic Programs and the establishment of the President's Council on International Economic and Foreign Policy were useful moves. They have resulted in an alerting of the President and the Cabinet to the situation and the need for action. Perhaps the forthcoming report of the Commission on International Trade and Investment will be helpful. But at present there is little understanding or concern at lower levels in the government.

The Board of Governors of the Federal Reserve System clearly recognizes the problem -- for they are the ones directly under pressure.

The Congress has heard the words, but it has a world of other problems so urgent that it has given relatively little thought to this distant problem that may not arise.

Over the past several years many academic people have recognized the possibility of the problem developing and have watched it do so, but many of them have watched with "benign neglect." That is, they have an intellectual understanding of the situation but have little concern because they feel there is no immediate crisis and, indeed, there is no certainty that one will develop at any later date.

Thus to date our people have not taken the problem seriously -- and there is a very real possibility that they won't do so -- unless something further occurs to disturb us and create concern. But what could occur?

The world may gradually express a preference for other currencies. When foreigners sell to us, they may ask for payment in Deutsche marks or Swiss francs, or even yen. The dollar will not actually be accepted at its stated value. We have seen some of this in recent days. We may soon see it in a more extreme degree. As has occurred with many other depreciating currencies, there may be two prices: the stated legal price of $35 an ounce, and a lower price in the actual markets of the world. This would be a de facto devaluation. It might or might not be followed by a further revaluation of other currencies upward in relation to the dollar as the Swiss franc and the Austrian schilling have recently been revalued. Germany's decision to float the Deutsche mark is likely to be followed within another six weeks by a new revaluation. However, the failure of France and Italy to cooperate will add to the already considerable internal pressure on the German government to moderate any change. Thus, the revaluation is likely to be inadequate with the result that further changes may be necessary within a relatively short period. The net effect of any such change will

be unpleasant to our people as they would make all imports more expensive -- but temporarily it would improve our position as it would tend to reduce our imports and increase our exports.

Unless and until we as a nation accept the real possibility of such a denigration of the dollar, we will not be willing to take the courses of action necessary to avoid such a catastrophe -- for the solutions are not pleasant.

B. We Must Discourage Other Countries From Selling Below Their Cost

In order to compete in world markets, we must get our costs and prices in line with those of other nations. To accomplish that, we must limit our costs and profits to the level of those in competing countries. But we must also insist that the rules of the game be enforced and see to it that our competitors do not sell below their cost.

In the General Agreement on Tariffs and Trade (GATT) effective in 1948 (and in the subsequent years as additional countries signed this Agreement), all of the major trading nations agreed that dumping -- by which exports are sold at less than the comparable price in the exporting country (after allowance for differences in taxation, conditions and terms of sale, and other differences affecting price comparability) -- should be prohibited. While we may levy anti-dumping duties, this is a complicated and time-consuming procedure. Moreover, under the GATT rules exports can be exempted from certain taxes, such as the value added tax which is widely used in Europe.

Nor are the rules governing subsidies on exports very effective. Subsidies are not adequately defined, and are typically very difficult to identify because they may arise from many indirect measures and domestic policies followed by the various governments.

Over the past decade, and especially in the last five years, our principal trading partners have had much more moderate increases in export prices than in their general domestic price indices.

EXPORT AND DOMESTIC CONSUMER PRICE INDICES for THE UNITED STATES AND MAJOR INDUSTRIAL COUNTRIES *
(1963=100)

	U. S.		Canada		Japan		France		Germany		Italy		U. K.	
Year	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom
1960	99	96	a	96	102	82	99	89	93	91	102	83	95	91
1961	101	97	104	97	98	87	100	91	98	94	98	84	96	94
1962	100	98	100	98	98	93	99	95	100	97	98	93	97	98
1963	100	100	100	100	100	100	100	100[b]	100	100	100	100	100	100
1964	101	101	101	102	101	104	104	103	100	102	101	106	102	103
1965	104	103	103	104	101	112	105	106	102	106	102	111	104	108
1966	107	106	107	108	101	117	108	109	103	110	101	113	108	112
1967	110	109	109	112	101	122	107	112	102	111	102	118	108	115
1968	111	114	113	117	102	129	106	117	101	113	101	119	101	121
1969	115	120	116	122	105	136	109	124	104	116	105	122	105	127
1970	122	127	123	126	110	146	111[c]	131	114	120	110[c]	128	111[c]	135

*Source: International Monetary Fund, International Financial Statistics, various issues.

a Component parts of Canadian export index changed in 1961; on previous index, value for 1960 would be 109.

b Statistical base for the French domestic index changed in 1963 and following years.

c The 1970 export indices for France, Italy and the United Kingdom are based on the first three quarters only of 1970.

The slower rise in export prices than in domestic prices may be explained (and justified) by the fact that in several instances export sales have increased so rapidly that unit labor costs have been reduced. In other instances wages for domestic services (as distinguished from manufacture) have risen without any corresponding improvement in efficiency so that domestic prices, including a large segment of services, may in fact have risen more rapidly than the prices of export items. This is true in our own case but to a much lesser degree.

But a suspicion remains that other nations do in fact offer inducements in the way of tax credits, low rate financing and in other ways to encourage exports. This results in some export prices below domestic prices -- and perhaps below cost.

Our government should explore this matter to ascertain:

First, whether the other nations are in violation of GATT; and

Second, if not, how we can achieve a more equal competitive position, either by adopting similar policies or by inducing other nations to abandon theirs.

In this and other relations with other trading nations, the United States must adopt a much tougher trading attitude than that which has appeared to characterize our post World War II negotiations. By this I do not mean that we should move in the direction of granting greater protection to our manufacturers. I mean instead that we insist that other countries grant less

protection, and less aid to their producers, and move toward a more open world of trade. Furthermore, that to induce them to do so we re-examine our whole inventory of persuasion, including aid, military assistance, our troops abroad, our fleet in the Mediterranean, and other influences that we can extend or withdraw as a part of our over-all negotiations.

C. We Must Get Our Costs and Prices in Line

As we stated at the outset, we could improve our balance of payments through reducing imports, tourism and investment. Such steps may be tempting because they would be easier to achieve, but they defeat our long-run purpose of a more open world for trade and investment.

Another alternative would be to eliminate, or at least reduce substantially, our foreign aid and military assistance programs and our disproportionate expenditures for the defense of the free world. These reductions alone would get us into balance on a liquidity basis. But we appear to be committed to a continuance of these expenditures. They are undoubtedly desirable -- but so is the preservation of the dollar's acceptability. It is a question of priorities.

Thus, we face the remaining alternative of getting our costs and prices in line with world markets. We can do this in either of two ways, reducing our (dollar)costs -- or by devaluation.

1. Can We Reduce Our Dollar Costs?

The most direct way to improve our exports is to get our dollar prices down to or below the level of competitive world prices

Ways to achieve that include: lowering wages, eliminating restrictive labor practices and reducing profits. None of these commends itself to the people who would suffer therefrom. This crisis, if it be done, does not inspire patriotism. There are few heroes in the war against inflation. Consequently, we may not be willing to pay the price -- a high price.

In stating the problem, we must be careful not to overstate it. We need not get our costs down. We merely need to slow the rate of rise. Our competitors' costs are rising too. Our goal should be to hold our rise in costs sufficiently below that of other nations so that their costs gradually catch up with ours.

Is this possible?

(a) An optimistic viewpoint

Yes, indeed, it is possible, and we achieved it in the years 1957 through 1964 when our prices rose only 1 per cent a year. Indeed, we were able to hold the rate of increase in our unit labor costs below those of the other competing nations.

Per Cent Increase From 1957 To 1964

	Hourly Earnings	Output Per Manhour	Wage Costs Per Unit of Output
Japan	81	46	25
Germany	81	47	24
France	73	40	23
England	43	29	14
U.S.A.	31	27	4

We are doing it again now. During 1970 such figures which are available suggest that we again had a lower increase in our unit labor costs than did our competitors.

Per Cent Increase In 1970

	Hourly Earnings	Output Per Manhour	Wage Costs Per Unit of Output
Japan *	18	10	8
Germany *	8	-1	9
France *	7	4	3
England *	11	1	10
U.S.A.	4	1	5

* First nine months of 1970.

Although we do not have statistics, it would appear that our unit labor costs during the first quarter of 1971 have grown at a more moderate rate than did those of our principal competitors.

So it can be done.

(b) A pessimistic viewpoint

We did it from 1957 through 1964, but at an average cost of 6 per cent unemployment, indeed, 6.8 per cent in 1958 and 1960 -- a sufficiently unpopular state of affairs so that in 1960 John Kennedy, when a Presidential candidate, could successfully campaign with the promise "to get the country moving again."

As a consequence of that philosophy and the escalation of our expenditures in Vietnam from 1964 on, our labor costs rose far more rapidly than did those of the other nations.

Per Cent Increase From 1964 To 1969

	Hourly Earnings	Output Per Manhour	Wage Costs Per Unit of Output
Japan	89	77	7
Germany	38	31	6
France	49	41	7
England	41	22	17
U.S.A.	28	14	14

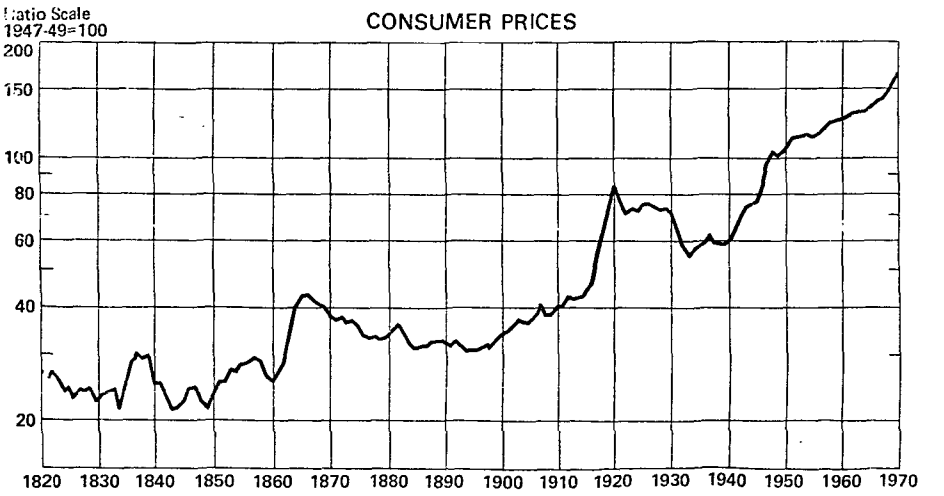
We are going through the same cycle once again. The restrictive monetary policies which achieved the present degree of stabilization caused a 6 per cent unemployment rate. Again that was unacceptable and consequently led directly to the relaxation of the restrictive monetary and fiscal policies beginning in February of 1970. The Nixon Administration hopes (as do we all) that by a most precise exercise of monetary and fiscal policy, it will be possible to overcome unemployment and yet keep our annual price rise to perhaps a 3-1/2 per cent level.

If the stimulative policies increase production more rapidly than employment, we will achieve greater efficiency and lower costs -- at least for a period. This is to be urgently desired. However, as times goes on, unless the stimulation is effectively moderated, it may appear that in the early seventies, as in the late sixties, the goal of containing inflation was quickly replaced by the more popular effort to reduce unemployment with inflationary results. Unfortunate as this would be, it would appear to reflect the desires of the American people. Employment comes first. Stable prices are down a ways in the list of priorities and the balance of payments surplus is close to the bottom. However, the test of political leadership is not merely to cater to the public's emotions, but to inform and influence the public's attitudes toward those goals that are in the public interest.

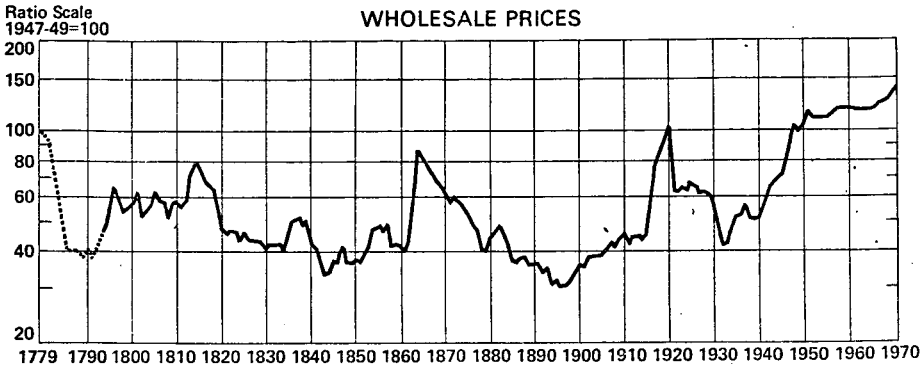
(c) A realistic viewpoint

As we have not been of a mind to set as high a priority on a stable currency as on growth and full employment, there is a persistent bias in favor of price increases. This has caused us to assume that such a bias is inevitable.

However, over the past 150 years, from 1820 to 1970, the bias was not very great. It took almost a century, from 1820 to World War I, for consumer prices to double, that is, an annual growth rate of about one per cent. There were in fact recurring periods of rapid rises (in most instances these were associated with wars), but they were usually followed by periods of sharp decline.



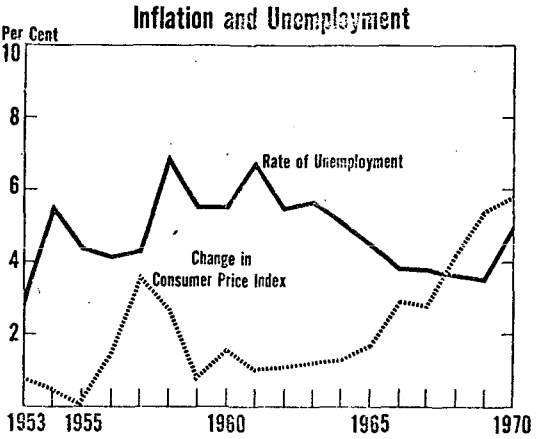
Adapted from a chart prepared by the Federal Reserve Bank of St. Louis



Adapted from a chart prepared by the Federal Reserve Bank of St. Louis

Since 1940, prices have risen almost continuously. On the basis of the earlier periods, we might have anticipated that the sharp rises during World War II, Korea and Vietnam would be followed by periods of significant declines as government expenditures declined, unemployment increased and prices were reduced. However, no such declines have occurred since World War II. Presumably this is due to the government's efforts to avoid any serious post-war recessions through the instrument of the Employment Act of 1946.

It is to be fervently hoped that in time we will learn how to moderate expansionary forces without increasing unemployment, but to date we have not discovered that secret.



An objective analysis might conclude that as a nation we should reappraise the price we pay for full employment. But today the public is not in a mood for such an examination. Lower income groups are deeply concerned about present levels of unemployment and higher income groups are not disposed to accept the higher tax rates necessary to provide more equitable treatment for those who are made jobless (in order to preserve the purchasing power of the dollar in the hands of those more affluent). For the present, at least, we are captives of the philosophy, and the law, of the Employment Act and its upward influence on costs and prices.

In considering costs of U.S. manufacturing, we must also recognize that the current concern with the environment is something of a handicap to export sales. The cost (whether direct

expense or indirect taxes) of cleaner air and water are costs which must be included in our prices and, to the extent that our country sets higher standards in these respects, our costs and prices will include that much more of an expense item. The same is true of the costs involved in foreign aid and military assistance to other countries. These expenses (or interest on debt incurred to defray such expenses) are included in our costs to a considerably greater extent than they are in the cases of Japan or Germany.

The lessons of the past would seem to suggest that our price increases can be held below those of our competitors, but there are several pre-conditions for such a goal.

First, the public must be convinced that the problem is sufficiently serious to warrant some sacrifice.

Second, the control and prevention of inflation must be given a higher priority than it has received in the past. This will mean appropriate fiscal and monetary policies to prevent excessive demands from initiating another round of inflationary pressures in the future.

Third, we must develop methods to make economic stabilization policies more acceptable to the public. It is not enough to insist on a restrictive monetary policy, which drives interest rates so high as to inhibit housing and high priority municipal projects. We must use fiscal policy more effectively, so as to prevent such situations from developing.

Fourth, we should develop policies to alleviate the inequitable burden of unemployment. This might involve specific taxes so that the employed and the wealthy would bear more of the costs of moderating inflation and preserving the value of the dollar. These

policies should be combined with others, removing restrictive practices and inefficiencies, retraining the parts of the labor force where skills are needed, and enabling more rapid gains in productivity.

Fifth, this process might be aided by some restraint on wage and price increases -- but is any such restraint practical? Canada's recent experience would suggest that a voluntary incomes policy is ineffective. A legal freeze might have been helpful during 1969 when we had restrictive monetary and fiscal policies, but it would be inconsistent with the present expansionary policies.

If we are to be realistic, can we expect acquiescence in such an over-all program by the American public or its Congress?

Not in 1971.

Not while we are polarized by Vietnam.

Not immediately before a national political election. (That may explain the Administration's choice of the fourth alternative -- inaction.)

But in 1973? Perhaps. A second-term President, intent on gaining Congressional support, might possibly achieve credibility with the people and a degree of cooperation from the Congress. It is far from certain -- but it is worth a try.

Before leaving this all-important matter of achieving lower export prices, we should acknowledge one remaining hurdle.

In general, aside from the growth of world reserves, over-all international payments must balance with one nation's deficit balancing another's surplus. If the United States is to achieve a balance, then some other nation with a deficit must have a greater deficit or some nation now in surplus must have a smaller surplus or a deficit.

The foreign nations which now enjoy balance of payments surpluses will be unhappy to see us convert their surpluses to deficits as our lower prices stimulate our exports. They could offset our lower prices by themselves devaluing their own currencies. That is a possibility, but not one so serious as to discourage our determination to become competitive. The mere fact that a nation is unwilling to revalue is not evidence that it is willing to devalue. If we merely achieve a balance or a minor deficit, it is not likely to provoke devaluation of other significant currencies.

D. We Should Stimulate Our Technological Lead

Another way to improve our exports is to concentrate on our strength -- our technology. We can't sell significantly more low technology items, textiles, shoes, processed foods, radios. They can be obtained elsewhere at lower cost.

The markets that we have kept and expanded are the markets for our high technology products.

U. S. TRADE (Billions of Dollars)

	Technology Intensive Manufactured Goods			All Merchandise Trade		
	Exports	Imports	Balance	Exports	Imports	Balance
1951-55 (Average)	6.6	0.9	5.7	15.3	10.9	4.4
1957	8.8	1.6	7.2	20.8	13.3	7.5
1962	10.2	2.5	7.7	21.5	16.5	5.0
1964	12.1	3.1	9.0	26.3	18.7	7.6
1969	20.5	11.3	9.2	37.4	36.0	1.4

Our technology generally has been far in advance of that of our foreign competitors -- the result of our more advanced domestic market, the inventiveness of our scientists and engineers, and the greater research efforts of our industry, government and our great universities. But technical advantages are not permanent.

The expanded interchange of knowledge, people and capital goods has enabled our competitors to do very well by adopting our techniques and discoveries, making them suitable to their own needs.

So that advantage is continually being reduced. Actually, we must run very fast in order just to stand still. As the European and Asian markets advance, they are expanding their research and development efforts.

Airplanes and computers have been great money earners abroad for the United States. Every country wanted these new products, but no other country could make them in as large a volume and, hence, at as low a cost. But in time, unless we keep a significant technological lead, computers are likely to go the way of automobiles. We used to export them -- now we are a net importer of about one million per year. We are still ahead in aircraft, but we have just withdrawn from leadership in -- and, indeed, from competition for -- the next generation of aircraft, at least in terms of speed, the SST.

Are we prepared to stimulate our technological lead? Are we even prepared to maintain our present lead? A technological lead lasts only a year or two unless new innovations are continuously developed. We have been told that Japan is now turning out more engineers each year than are we. Enrollment in our engineering schools, which rose so rapidly after Sputnik, has generally leveled off and begun to decline, partly because of presently unfavorable

job market opportunities. Much of our research and development in television and electronics is now done abroad. Research is cheaper in Japan and equally creative.

Our corporations remain innovative and spend much on research and development -- but increasingly they find it easier to move their production to areas of low labor cost rather than to hazard millions in the uncertain pursuit of new techniques.

Perhaps the government should support applied research on commercial and industrial products, but Congress may prevent any such effort.

E. We Should Offer a Tax Incentive

A tax incentive is a subsidy. It is the grant of Federal revenue without specific Congressional allocation. Tax incentives are not generally in the public interest. But in this instance we are asking both labor and management to sacrifice some personal benefits in order to achieve price stability and overcome our dollar problem. In these circumstances it would seem appropriate for the government to contribute through a tax incentive.

The Administration has proposed, and is encouraging Congress to adopt, the so-called DISC. Under this proposal a corporation would be authorized to set up a Domestic International Sales Corporation (DISC) to handle its export business. Tax deferral and other concessions would be granted to the DISC

subsidiary in order to reward exports. Such concessions are comparable to the special benefits that many foreign governments have granted to their exporters. If I were free to write a tax incentive, I would relate the benefit to increases in exports, whereas the DISC proposal rewards the existing volume of exports. However, in view of the Administration's support of DISC, it might have a far better chance of passage. As DISC would be far preferable to no tax incentive, it should be enacted.

F. We May Have to Change the Parity of the Dollar in Relation to Other Currencies

As we stated in our opening paragraphs, if we are not prepared to restrict our expenditures abroad, we must increase our exports. To do that we must reduce our costs and prices either in dollar terms or in terms of other currencies. We would be far better off to reduce our dollar costs. But if labor prevents that then our only alternative is to reduce our costs and prices in terms of other currencies -- that is devalue the dollar -- or revalue the other currencies.

1. Unilateral devaluation.

We could devalue. We could simply say the dollar isn't worth as much as it was. Instead of being 1/35th of an ounce of gold, we could say it is now worth only 1/40th of an ounce or 1/45th of an ounce. Of course, that is a bit rough on the foreign central banks that have held the dollars in reliance on our willingness to preserve their value. Such an increase in the price of gold would primarily benefit those who hold significant amounts of gold and

those who produce it, primarily Russia and South Africa. It wouldn't give us enough more gold to make any appreciable improvement in our ability to redeem our dollars. To accomplish that we would have to double or triple the price of gold. It probably would not make our exports (priced in dollars) any lower priced in relation to the foreign buyer's foreign currency, however, because the parities of other currencies are expressed both in terms of the dollar and gold. Thus, other countries would tend to offset our unilateral change in the gold price by raising their own gold price, leaving the exchange rate between the dollar and their own currency unaltered. A unilateral devaluation would, therefore, mean little more than an increase in the price of gold.

2. Devaluation of the Dollar by International Agreement.

Although other nations (after consultation with the IMF) can devalue their currencies, to reduce the value of the dollar relative to other major currencies would require an agreement (and some preliminary negotiations) with those other countries. Despite their criticism of our balance of payments deficit, they may not be agreeable to an adjustment of parities which would significantly stimulate our exports and inhibit our imports.

But assuming they would agree, would it be wise for the United States to devalue?

If we just devalued and didn't get our costs down, or reduce foreign expenditures for aid or invisibles, or step up our technological lead, then the benefit of our temporarily reduced costs (only in relation to other currencies) would be offset as labor and business both sought to increase their rewards (wages and profits) in dollar terms in order to enable them to pay the new higher prices (in dollars) for imports.

In England after the last (November 1967) devaluation, of 14 per cent, wages and prices rose fairly quickly and the benefit from the devaluation was relatively short-lived. The benefit from any devaluation of ours might last somewhat longer because our citizens' expenditures for imports are not so large a proportion of their total expenditures as they are in England and most other countries. Consequently, the necessity for "catching up" with import prices might not provide so strong a motivation to our people as to the English.

Thus, devaluation is not really a satisfactory solution, at least by itself. It might conceivably be useful as a temporary secondary weapon if we were prepared to attack the underlying problem directly with one or more of the following: reduction of restrictive labor practices, freezing of wages and prices, or an intensive drive to stimulate development and export of high technology

products. Alone, unilateral devaluation is of such short-term value that it hardly warrants the implications of failure and loss of prestige which it involves.

3. Multi-lateral readjustment of parities

The present parities (or an agreed relationship between the values of various national currencies) were not ordained by the Lord. In the summer of 1944, as World War II drew to a close, the United States and Britain initiated a meeting at the little New Hampshire resort town of Bretton Woods, following which parities were established in December, 1946, for 25 currencies. Since 1946 an additional 58 countries have done likewise. In the 26 years since then, 19 of the original 25 countries have devalued their currencies in relation to the dollar and by a total of 38 times.

Some of our most significant trading partners have resorted to this means of reducing their export prices and discouraging imports.

National Currency	1946 Agreed Value in Dollar Terms	Number of Devaluations	Number of Upward Revaluations	As of 3/30/71 Relationship to the Dollar	Per Cent Change
England	$ 4.03	2	-	$2.40	-40
France[1]	0.84	5	-	0.18	-79
Italy[2]	0.0044	3	-	0.0016	-64
Germany[3]	0.303	1	2	0.273	-10
Japan[4]	0.0028	-	-	0.0028	-

1. From January 26, 1948, to December 28, 1958, France had no par value established with the IMF, a period during which the franc was devalued four times.

Thus, although the dollar is under pressure today, it has done very well as against other currencies over the past quarter century. Any devaluation which we might agree to today would still leave the dollar in a stronger relationship to all other currencies (other than the yen and Deutsche mark) than when the parities were established in 1948.

Aside from bolstering our own pride, the above table suggests that currencies cannot long have fixed relationships when they are issued by governments which have significantly different monetary and fiscal policies and experience different price trends.

A unilateral devaluation may be a satisfactory solution for a smaller nation whose currency is under temporary stress. But as virtually all other currencies are based on the dollar, the United States should not move unilaterally. However, if we could achieve agreement, we might initiate a new series of parities, either on a broad scale through a second Bretton Woods-type meeting, or more quickly (with far less disruption of trade) through the Group of Ten (leading nations).

2. Italy did not establish a par value with the IMF until March 30, 1960. Between 1946 and 1960 the lira was devalued three times.
3. The Deutsche mark which was created in 1948 had no established IMF par value until January 30, 1953. The initial Deutsche mark rate was 30¢, but in the 1949 devaluation the mark was also devalued -- to 23.8¢.
4. The Japanese yen, following a series of post-World War II devaluations, was established as a civilian currency in April, 1949, with an official exchange rate of $0.0028. This rate was established with the IMF on May 11, 1953.

be under way as it would best be accomplished secretly. However, the newly established parities would require subsequent legislative affirmation.

This might be a wise course and should also include provision for somewhat greater flexibility in the fluctuation of parities.

G. We Should Not Attempt to Improve Our Position Through Controls of Imports or Capital Movements

One of the greatest threats to the continued growth of international trade is the possibility of increased nationalism with its restrictions. Last year our country, long a leader in freeing trade, came close to a disastrous decision to seriously restrict imports. The risk remains -- but we must resist temptation to impose controls.

1. As to Imports

Whenever a particular industry finds itself at a disadvantage in competition with foreign producers -- especially in competition for domestic markets -- it is tempted to ask for government assistance in the way of trade barriers, either tariffs, non-tariff barriers or negotiated agreements, to prevent or limit the importation from lower cost producers abroad. Except in respect to some rare product without which we could not survive in a period of war or restricted shipping, we should not give in to such pressures.

To adopt such a restrictive policy would have two effects:

(a) The American consumer would have to pay more (to the domestic producers) than he would otherwise have to pay (if the foreign goods were admitted and sold for less).

(b) The almost certain prospect of foreign retaliation against United States exports would only reverse the progress we have made toward a more open world.

We should reaffirm our commitment to freer trade, insisting, of course, that such trade be a two-way street.

There will be injustices but, although it is of only moderate help, we must rely on adjustment assistance to injured industries and to displaced workers. The gains from trade are broadly distributed in the form of lower prices to consumers and higher wages in the export industries. The costs and dislocations imposed by imports upon domestic producers and workers are sometimes quite concentrated, however, and the transfer of these displaced resources to other more productive industries should be assisted. Just as the country should not have to bear the costs of indefinitely supporting high-cost workers or firms, neither does it seem proper that the costs of adjusting to trade should fall only upon the displaced firms and workers.

2. As to Exports of Capital

Another alternative would be to adopt severe controls over the international flow of funds by limiting one or more types of expenditures abroad. Other nations have maintained their payments-balance through such controls. This device can be effective and is tempting. But it has two significant disadvantages. First, it is a step away from our goal of an open world. Second, to limit our investments abroad would be to kill the goose that lays the golden eggs. Already we are getting back more each year in earnings on earlier investments than we send abroad in new investments. In 1970, our net foreign investment income of $6.0 billion exceeded our net investment outlays of $2.5 billion by about $3.5 billion.

Furthermore, it would be a major error for our government to restrict our right to invest abroad while we still have that opportunity, particularly in view of the fact that foreign governments (turning more nationalistic) may in the years ahead restrict that opportunity.

* * * * * * * * *

If we are willing to hold our inflation to a safe 3-1/2 per cent or perhaps even lower, while others increase their prices by 5 to 6 per cent rates, and if we are willing to work as hard as the other nations, we may -- just possibly may -- be able to avoid

devaluation. But over a period of time, unless we are willing to work harder than others, we may have to accept a decline in our relative living standard. That may hurt our pride.

To hold our inflation rate to 3-1/2 per cent may involve higher levels of unemployment than we will accept. It might also require higher taxes (in order to take decent and just care of the unemployed). Are we willing to pay that price? Will we be willing to postpone further shortening of the workweek until our competitors are down to the same level? Are we willing to work more intensively while we are at our desks or machines?

If not, we will follow Britain's course and sustain a significant decline in influence.

If, as a nation, we are willing to rearrange our priorities and recognize that what we do domestically has an effect on our international relations, accepting in our domestic lives the disciplines which those international relations inevitably impose upon us -- then we can gradually get our costs in line, reduce certain of our international commitments, and get our payments in balance. Such a course would encourage the foreign holders to spend their dollars to buy our goods (rather than our gold) with a welcome stimulating effect on our domestic economy.

Our decision on this issue will affect both our international and domestic relationships.

H. We Must Encourage Our Creditors to Forbear While We Get Our Payments into Balance

Our short-term liabilities to Germany alone approximate our entire assets (gold supply plus our convertible currencies and drawing rights). Canada, Japan, Italy and France have claims amounting to another $12.9 billion. Will they wait long enough to see the outcome -- to judge whether our governmental policies (perhaps of several Administrations) will get our payments into balance?

The most effective inducement would be concrete evidence of our determination to enhance the dollar's competitive purchasing power.

There may be other alternatives. If we had an asset that we could offer in lieu of gold, it might encourage other central banks to continue to hold their dollars without complaint. But do we have any such assets that would be acceptable to the foreign central banks which are quite properly extremely conservative? They like to be sure that any asset held as a reserve will be acceptable by all other nations in the settlement of accounts. Gold has been the historic medium and retains its acceptability. It was for some time supplemented by sterling and now by the dollar. Commonwealth countries still rely on sterling and some countries, historically associated with France, still rely on francs for their reserves. But gold and the dollar are the most desirable. The dollar's position was due to the certainty of its convertibility into 1/35th of an ounce of gold.

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The acceptance of SDRs (essentially credit balances in the IMF) was quite a courageous step for it was the substitution of an asset with --

(1) No intrinsic value, and hence,

(2) Which could have no utility except in transactions between central banks.

Its acceptance largely rests on the agreement among the central banks to accept it in payment of international accounts, but this acceptance is based upon the expectation that the United States would reduce its deficit, and so provide a smaller volume of dollars to the world in the future. This we have not done, and until we do, it is not likely that SDRs will serve an important purpose in the present system.

The United States has a much more valuable asset -- our productive profitable corporations, the ownership of which is represented by transferable ownership of stock.

If the United States Treasury were to buy such stocks and offer them (at some discount from market) to foreign central banks, they would have a more inherent value than gold and, furthermore, would produce income. Were they transferable only amongst central banks (for a 10- or 15-year period), they would have most of the characteristics desired in a reserve asset -- except that they would not have a fixed value in any terms -- and their fluctuating aggregate market value would have no relationship to gold. This one lack would probably disqualify them as a reserve asset at this time. However, because of their intrinsic value and their

probable appreciation in terms of any currency, they may be acceptable some day -- even though not today.

An alternative would be to attempt to reduce the pressure on the foreign central banks by inducing foreign individual citizens and commercial banks to buy and hold American securities for their intrinsic value. The development of the Eurodollar market indicates that this might be attainable to a significant degree over a period of time, but it would not serve our immediate purpose of deterring the foreign central banks from presenting their dollars for gold.

Another alternative would be an attempt to induce (perhaps through offering some tax incentive) foreign corporations to invest in plants in our country. Either of these steps might cause some foreign held dollars to come home -- thus reducing pressure on the foreign central banks.

But these are only remote possibilities. We do not seem to have anything that can effectively postpone the urgent demands of the central banks except evidence of our determination to get our prices down to competitive levels and thus repatriate dollars in exchange for our manufactured products.

III. RECAPITULATION

Our country has a problem. Dollar claims are building up abroad. They far exceed our capacity to pay in gold and, due to our higher prices, the dollars are not exchanged for our goods. We

must understand this and acknowledge its importance. We must work toward a solution, first, by encouraging other nations to reduce the non-tariff trade barriers that exclude our products and either encourage the other countries to eliminate (or ourselves to adopt) export stimulates in the form of tax incentives, low interest rate credits, etc.

The complete solution to our problem requires either lessened expenditures abroad -- for which we do not seem prepared -- or an increase in our export sales which requires more competitive prices. We can achieve lower costs in only two ways -- by reducing our dollar costs -- holding down our unit labor costs, or by reducing the value of the dollar relative to other currencies.

To achieve a reduction in our dollar costs, or at least a slower increase in our costs (in dollars, not in percentages) than in the costs of competing trading nations is not an easy task nor a politically popular one, but it is essential. We also can help our exports by stimulating technological advancements in our export industries.

But if these mechanisms fail, we will have to change the parity of the dollar in relation to other currencies, and this can only be done under a multilateral arrangement.

We should not attempt to improve our position through controls of imports or capital movements as these are shortsighted and self-defeating.

While we are attempting to achieve our basic goal of getting dollar prices in line with those in world markets, it would be helpful if we could induce the foreign central banks to restrain their presentation of dollars for the gold we do not have. Without a doubt, the best deterrent would be evidence of our determination to get our prices in line.

Our ultimate attainment of competitive prices would result in an inflow of dollars from abroad and excellent business, employment and profits for our own country.

Our international and domestic goals are parallel.

INTERNATIONAL TRADE CLUB
OF CHICAGO

THE VOICE OF MID-AMERICA IN WORLD TRADE

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INTERNATIONAL TRADE CLUB OF CHICAGO

STATEMENT OF POLICY*

PREFATORY NOTE

The International Trade Club of Chicago, which originated in 1919, has a current membership of over 700 top executives, representing some 600 Mid-America firms with substantial international business interests. The companies which these executives represent are engaged in all of the major fields of international trade and investment. They include manufacturers, exporters and importers, transportation companies and firms providing various services to companies engaged in international trade, business and investment.

The primary objective of the International Trade Club of Chicago is to represent the export, import and foreign business interests and foreign operations of Mid-American business and industry as well as Mid-America investment interests of foreign industry. In this respect, it should be noted that Illinois is the leading agricultural export state and the third-largest exporter of manufactured goods in the United States with international sales of about three billion dollars in 1970.

Members of the International Trade Club of Chicago do hereby express themselves in favor of the following principles and policies and recommend them to the President of the United States, the Congress of the United States, the Governor of the State of Illinois, and to other concerned agencies of federal, state and local governments for careful consideration and implementation.

UNITED STATES FOREIGN TRADE POLICY

We strongly believe that the United States will benefit most from a trade policy directed at encouraging world

* Submitted by Manuel J. Correa, President

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trade on a multilateral and non-discriminatory basis. We support the general elimination of tariff and non-tariff barriers to international trade, and the continued application of the Most Favored Nation principle. Such a policy would be in accord with United States actions in this field since 1934. In implementing this policy, we believe that better understanding can be established with our trading partners than has been the case in the past. We also recognize that it may be desirable to make certain exceptions in the case of developing countries.

The United States currently finds itself under great pressure from special interest groups to compromise its long-standing policy advocating freer trade and to shift to one of protectionism. Although these forces have been present throughout our recent trade policy history, they are today receiving encouragement from the highest levels as evidenced by strong Congressional support during 1970 for a bill which would have imposed quotas and other import restrictions. Such protectionist measures are of most economic harm to low-income groups. We are firmly opposed to such quotas and restrictions, and call for a return to our policy of promoting freer trade.

The protectionist policy contained in the proposed 1970 Trade Bill would have encouraged retaliation by other nations resulting in trade contraction and economic nationalism. Protectionism would adversely affect the United States balance of payments and weaken the relative position of the United States in the world economy. It could also adversely affect our access to strategic materials not available domestically. Protectionism would mean that the United States would be unable to encourage effectively the dismantling of trade restrictions which discriminate against American exports and which inhibit the growth of American export sales. The United States should in no way, by legislation or otherwise, implement protectionist measures. Rather, it should use all its efforts to encourage other countries to dismantle trade restrictions and other barriers to the free flow of international trade.

In order to further a more liberal trade policy, a number of measures need to be taken. These include:

1. Giving the President adequate authorization to negotiate tariff reductions, at least on a "housekeeping" basis.

2. Elimination of the American Selling Price System.

3. Adoption of more expeditious handling procedures for anti-dumping complaints and cases.

4. Where quotas exist they should be phased out unless pragmatic circumstances dictate modification. No new quotas should be admitted.

5. Improvement of customs clearance procedures.

6. Continued elimination of restrictive U. S. and foreign government procurement policies and procedures. Where elimination is not practical, full disclosure should be made.

7. The elimination of taxes which discriminate against imports.

TRADING BLOCS

We support the principle of free trade areas or customs unions such as the European Economic Community, provided that their formation does not result in a higher level of external tariff, or other barriers to trade, than would have existed in the absence of such a trading group, and provided they amount to a close-knit, single economic entity and not a device for preferential trading groups. If properly used, such arrangements provide greater economic stability and growth for the countries concerned, enhancing the opportunities for U. S. investment and trade; if not properly used, they run counter to a non-discriminatory, multilateral and world trade environment.

EXPORT EXPANSION AND BALANCE OF PAYMENTS

The problems that the United States faces in its international accounts continue to receive public attention. One segment which is amenable to improvement is the trade balance. It is best strengthened by expanding exports, rather than limiting imports. We call upon the Administration to undertake all feasible measures to promote export expansion as rapidly as possible.

First steps should be:

1. Eliminating restrictions on export financing by banks and other financial institutions.

2. Providing fiscal incentives to increase exports through
   a. Measures similar to the DISC provisions of the proposed 1970 bill.
   b. Interest subsidies or other special discount facilities for export credit.

3. Making more flexible the operations of both the Export-Import Bank, including removal of net loans from the budget, and the Foreign Credit Insurance Association and simplifying and improving their procedures.

4. Extending Eximbank financing facilities to short-term export credits.

OVERSEAS PRIVATE INVESTMENT

Overseas investments have contributed to a sharp increase in our international net worth, according to Dr. H. Houthakker of the President's Council of Economic Advisors. During the 1960-69 period, our international net worth more than doubled and rose to $67 billion.

Direct private investments abroad by American corporations and individuals generally serve the needs of the nation. They stimulate American exports, provide a steady flow of investment income receipts and promote economic development throughout the world. The current Administration has taken steps to reduce the adverse effects of the Capital Restraints program. We strongly urge it to go further and eliminate all restrictions on new investments abroad.

We also request the Administration to utilize the new Overseas Private Investment Corporation as a device to stimulate U. S. foreign investment. We urge that this be done in such a way as to substantially encourage the expansion abroad of the operations of U. S. businesses.

The U. S. Government should use its efforts to cause other nations, such as Japan, Mexico or India, to dismantle restrictions against foreign private investment.

We encourage Government to negotiate more double taxation treaties. This will eliminate disputes and provide a further incentive for foreign investment.

DEVELOPING NATIONS

As the gap in wealth between the developed and developing worlds continues to enlarge, the resulting tensions are likely to be disruptive to world trade and to the orderly expansion of U. S. investment interests abroad. To help ease this situation, we support measures designed to encourage the economic growth of the developing world.

This should include a combination of:

1. Financial aid.

2. International agreements on important world commodities which will stabilize prices and provide for orderly growth.

3. Support of the President's policy for expanding the preferential access of poor nations to markets of the developed world.

4. Elimination of non-tariff barriers on products of special concern to developing countries.

EXPROPRIATION

While recognizing the right of every country to expropriate private property in its national interest, we regret that some nations have found United States' businesses to be particularly inviting targets, nor have such countries adhered to the rule of fair and prompt compensation. To lessen the possibility of bilateral political confrontations over this type of issue, yet still provide an incentive for the growth of U. S. investments in the less developed world, we urge the United States to:

a. encourage a firm international posture by all developed countries on the necessity for obtaining fair and prompt compensation in the event of nationalization.

b. develop an international insurance plan on a business-like

basis, which adequately insures new and existing businesses against such an eventuality without the government involvement that customarily occurs.

c. consider strengthening the arbitration procedures of the World Bank's International Centre for the Settlement of Investment Disputes.

d. encourage other countries, such as those parties to the Andean Treaty, to provide fair and immediate payment to foreign investors when they are forced to reduce their holdings to a minority position.

e. rescind the Hickenlooper Amendment to the Foreign Assistance Act as it has proven to be counterproductive.

EAST-WEST TRADE

While some liberalization of trade between East and West has taken place, of which we approve, the removal of additional restraints is urged in order to avoid loss of substantial markets to foreign competitors who have no such restrictions.

We support Eximbank financing for East-West trade and would urge Congress not to adopt measures which would prevent this.

Additional trade in this area should also be fostered in order to improve our trade balance. This should be accomplished through the further elimination of unnecessary prohibitions, retaining restrictions only on those goods which are deemed vital to our national security.

SURFACE TRANSPORTATION

We support the Administration's efforts to expand, modernize and make more competitive American-flag shipping. This is necessary as our merchant marine has deteriorated in the recent past and is becoming increasingly uncompetitive. We oppose labor practices and other measures that artificially restrain efficiency, such as the requirement that U. S. bottoms be used where export-import financing is involved.

The rapidly developing tendency throughout the world covering establishment of national flag and insurance preference laws and agreements on commercial cargoes should be vigorously opposed.

We support legislation which requires compulsory arbitration in the shipping and transportation disputes which clearly affect the national interest. Recurring strikes demonstrate the dangers to the effective conduct of international trade and damages suffered by the domestic economy from prolonged disputes. Shortages and higher prices of imported goods can be harmful to the American consumer. Failure to guarantee delivery or to meet delivery dates can lose markets for American suppliers.

AIR TRANSPORTATION

We urge the U. S. Government, working through the United Nations and other appropriate international bodies, to adopt stricted control measures over all flights and support a forceful policy, similar to that body of international law covering piracy on the high seas, to make air piracy an international crime.

Recognizing that improved communications have contributed to expanding U. S. business interests abroad, we urge the development of improved methods of air transporation. We vigorously support the Administration's efforts in this direction.

June 1971

STATEMENT OF EUGENE L. STEWART, GENERAL COUNSEL, TRADE RELATIONS COUNCIL OF THE U. S., INC., BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE, COMMITTEE ON FINANCE, U. S. SENATE

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for the opportunity to present a comprehensive analysis of the impact of foreign trade on U. S. manufacturing industries and their workers, pertinent to your consideration of the need for reform in U. S. Foreign Trade Policy.

The Trade Relations Council of the United States has as its primary objective undertaking to assist the Congress in its study of foreign trade policy by a systematic compilation and analysis of all available Government data pertinent to employment, output, and foreign trade of U. S. manufacturing industries.

Today it is my pleasure to present to the Subcommittee the Third Edition of our report, *Employment, Output, and Foreign Trade of U. S. Manufacturing Industries, 1958-68/69*. This two-volume work expands the scope of the earlier study by adding many new industries, and it updates the information previously presented through the year 1968 for employment and output, and the year 1969 for foreign trade. The 1968 data published in the Annual Survey of Manufactures are the latest available, and the 1969 foreign trade data are the latest available on computer tapes suitable for analysis in our data bank.

These volumes are too bulky to be reproduced in the Committee's printed hearings. I request, however, that they be made a part of the Committee's official record of its hearings.

The proper object of foreign trade legislation is to provide a means for protecting the standard of living necessary for the health, efficiency, and general well-being of workers in the United States from harm due to unregulated imports. It has been the public policy of the United States since the enactment of the first trade bill in 1789 to protect that standard of living through positive regulation of the flow of goods in commerce within the United States.

The Nation's basic fair labor standards legislation outlaws the manufacture and sale of goods in the United States under such conditions as to wages and hours as would undermine the minimum standard of living required to support the general well-being of workers in this Nation. When goods move in commerce, their capacity for undermining that standard of living is every bit as great in the case of goods made abroad under substandard wage and hour conditions as from goods made in the United States in violation of the standards contained in the Fair Labor Standards Act, as amended.

If the Congress is serious about the protection of the standard of living of American workers from the damage which would be caused by the unregulated sale in the United States of merchandise whose price advantage is based primarily on the failure to observe the wage and hour standards of our domestic legislation, it must of necessity provide for the regulation of all goods moving in commerce in the United States which would have that effect regardless of their origin.

To penalize the domestic production and sale of such goods while extending the open door of welcome to the same class of merchandise made under substandard labor conditions abroad is a clear and open breach

of faith on the part of the Congress with the American workingmen and women whose welfare the Congress ostensibly seeks to protect through the wage and hours legislation.

Accordingly, it is high time that this double standard of economic morality be terminated and that the Congress face up to the full consequences of its proper desire to place an economically realistic floor under the income of workers and a safeguarding ceiling over the hours which they are required to work at straight-time wages.

The need for legislation to close the gaping loophole in the protection afforded the standard of living of workers in U. S. manufacturing industries was never greater than it is today. To illustrate this fact to you, I should now like to summarize the data which are contained in the new and updated study which I have presented to the Subcommittee.

The study includes data on 329 of the Nation's 425 manufacturing industries defined at the 4-digit level of the Standard Industrial Classification, and on 634 of the 1,280 product classifications of U. S. manufacturing industries defined at the 5-digit level of that Classification.

There are 321 industries at the 4-digit level of the Standard industrial Classification for which complete data are available, either alone or in combination with other industries. These 321 industries accounted in 1968 for 70% of total employment in all U. S. manufacturing industries. The 321 industries supplied 82% of the value of shipments of manufactured goods in 1968. Products like or competitive with the output of these 321 industries accounted for 92% of total U. S. imports of manufactured goods in 1969, and for 83% of U. S. exports.

Within this group of 321 4-digit industries, there were 147 which experienced a balance of trade deficit in 1969, even when imports are taken at the value reported by the Department of Commerce (f.o.b. origin) and exports at their reported value (f.a.s. port). These 147 4-digit industries accounted for 37% of total employment in all manufacturing industries in 1968, and for 46% of the value of shipments. Most significantly, however, imports of articles like or competitive with the output of these 147 industries accounted for 78% of total imports of manufactured products in 1969, while the exports of these industries accounted for 34% of total U. S. exports of manufactures.

The balance of trade deficit (imports, landed cost; exports, valued mill) of these industries in 1968 was equivalent, at the value of shipments per worker in each of the 147 industries, to a net loss of 408,268 jobs. This figure does not represent an absolute loss of jobs in the sense of a one-for-one decline in total employment in these industries; however, the negative figure derived from the report of the job equivalent of foreign trade in these industries, of 408,268, does reasonably represent the aggregate of jobs lost and employment opportunities lost in these industries. Since the 147 industries preponderantly have comparatively high labor-intensive ratios, it may also be said that the lost job opportunities represented lost employment opportunities for comparatively unskilled workers who, in manufacturing, are chiefly employed by such industries.

The effect of foreign trade in the product categories of these 147 industries on the U. S. balance of payments was even more dramatic than the adverse employment effects described above. Taking imports and exports at the values reported by the Department of Commerce, foreign trade in products like or competitive with the output of these 147 industries resulted in a foreign trade deficit of $11.4 billion in 1969.

In marked contrast with the position of the 147 industries referred to above, analysis of the data in the report indicates that there is a separate group of 174 industries for whom foreign trade has had the opposite effect of that described for the 147 industries. This separate group of 174 industries accounted in 1968 for 34% of the total employment in all manufacturing industries, and for 36% of the value of shipments. Imports of products like or competitive with the output of the 174 industries accounted for only 14% of total imports of manufactured articles in 1969, whereas these industries supplied 49% of total U. S. exports of manufactures in that year.

Calculated at the Department of Commerce values, foreign trade in the product categories of these 174 industries resulted in a foreign trade surplus of $10.9 billion in 1969. Because the 174 industries are, in general, less labor intensive than the separate group of 147 industries previously described, the job equivalent of the foreign trade surplus (imports, landed cost; exports, valued mill) in 1968 in the product categories of the 174 industries was equivalent to 185,650

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jobs, considerably smaller than the job loss represented by the job equivalent of the foreign trade deficit resulting in the product areas of the 147 industries.

Up to this point in our analysis, the following lessons of importance to your Subcommittee's consideration emerge:

1. The industries in the United States with strong export potential were unable in 1969 to create a foreign trade surplus in their product lines great enough to overcome the foreign trade deficit which was experienced by the more labor-intensive, import-sensitive industries. The $10.9 billion foreign trade surplus earned by the 174 export-capable industries failed to match the $11.4 billion foreign trade deficit of the import-sensitive industries by a half billion dollars.
2. More importantly, the employment generated by the export performance of the capital-intensive, technologically superior export-capable industries fell far below the job losses attributable to the excessive imports which impacted the product lines of the import-sensitive, labor-intensive industries. Thus, the 185,650 jobs generated by the net export performance of the export-capable industries were seriously inadequate to make up for the loss of 408,268 jobs resulting from the net foreign trade deficit in the import-sensitive industries. The net shortfall in jobs resulting from our Nation's foreign trade in manufactured products was 222,618.

For the 223,000 Americans who lost out on meaningful employment because of the net impact of foreign trade on manufacturing industries in the United States, the public policy expressed in the Fair Labor Standards Act proves to be a hollow promise. These lost employment opportunities resulted precisely because of labor conditions abroad which are substandard under the guidelines established in the Fair Labor Standards Act, and which by the magnitude of the job losses are shown to be clearly detrimental to the maintenance of the minimum standard of living necessary for the health, efficiency, and general well-being of the affected workers.

To corroborate the accuracy of our findings, there is now available from a governmental source, for the first time, a measurement of job losses in U. S. manufacturing industries resulting from foreign trade. In a paper entitled "Export-Import Employment Relationship" supplied for the record in connection with his testimony before the Committee on Ways and Means of the House of Representatives last year, the Secretary of Labor indicated that in the year 1969, the employment equivalent of imports of manufactured articles was 1,600,000 while the employment related to merchandise exports was 1,432,000.[1] The net balance of employment attributable to foreign trade in 1969 was thus a deficit of 168,000 jobs. Moreover, this is to be compared with the similar data supplied by the Secretary for the year 1966 which indicated a net surplus

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[1] Hearings on Tariff and Trade Proposals Before the House Ways and Means Committee, 91st Cong., 2d Sess., pt. 2, at 608, 613 (1970).

of 79,000 jobs. Thus, the total change in employment attributable to foreign trade between 1966 and 1969 was a loss of 247,000 jobs in manufacturing industries.

To indicate the changes in the foreign trade position of U. S. manufacturing industries, I present for your consideration four tables of data.

In Table I, there are presented for each of 643 industries for which complete data were available, data measuring the balance of trade in the products of those industries for the years 1967 and 1969. These data are shown in the table under four columns, each of which is designed to provide a relative measurement of the competitive strength or weakness of U. S. manufacturing industries in foreign trade. Thus, the columns are headed:

I. Industries whose trade deficit grew larger;

II. Industries whose trade surplus was reduced;

III. Industries whose trade surplus grew larger; and

IV. Industries whose trade deficit was reduced.

The theory of these four subdivisions is that the measurement provided by the concept expressed in the column heading will identify industries in accordance with their relative strength or weakness in competing with their foreign counterparts. Thus, industries which had

already experienced a trade deficit by 1967 and which experienced an intensification or enlargement of that deficit by 1969 can reasonably be regarded as industries which are suffering a continued deterioration in their competitive position vis-à-vis total foreign trade. Because they are in a deficit position, imports are the dominant factor in the foreign trade position of these industries.

The second column expresses a concept under which industries which enjoyed a trade surplus can nevertheless be seen as undergoing a weakening of their competitive strength vis-à-vis foreign competition. The fact of a trade surplus in 1967 distinguishes these industries from those which experienced a deficit, but the added fact that the magnitude of the surplus is diminishing as shown by the 1969 balance of trade position identifies this second group of industries as those becoming less competitive in foreign trade but not yet characterized by dominating import injury.

In contrast to these two classifications, the concepts stated in the third and fourth columns of Table I measure industries which possess competitive strength vis-à-vis their foreign competition, and whose ability to compete is strengthening. This growing competitive strength is shown by the increase in the balance of trade surplus of industries which already enjoyed a trade surplus in 1967, or by the reduction in the size of the trade deficit in the case of industries which were in a deficit position in 1967.

In the latter case (industries which enjoyed a reduction in the balance of trade deficit), it is reasonable to conclude that the persistence of a trade deficit indicates that the affected industries are suffering in some degree from import competition, but that the pressure of such import competition is lessening or being counterbalanced to a significant degree by increased exports.

The data in Table I are grouped in numerical order under the 2-digit major industry descriptions of the Standard Industrial Classification. The principal emphasis was upon the presentation of data for industries measured at the 4-digit level of the Standard Industrial Classification. Wherever complete information was available, data are also presented for the 5-digit subdivisions of the 4-digit industries.

In order to achieve a matching of the differently classified import and export data under Standard Industrial Classification product classification concepts, it was necessary frequently to combine two or more 4-digit industries, and often to combine with one or more 4-digit industries, one or more 5-digit industries. These combinations are indicated in the industry description in the table.

The data presented in Table I appear to justify the following general conclusions in regard to the competitive position of the major 2-digit industry groups:

1. The industries which comprise the *food and kindred products* group (SIC 20) predominantly have experienced a weakening of their competitive position in world trade, though 24 of the 64 industries included within that group have improved their competitive position.
2. The *tobacco* industries (SIC 21) have strongly increased their competitive position.
3. The *textile mill products* industries (SIC 22) have experienced a strong downward turn in their competitive position in world trade, with 21 of the 36 industries which comprise that group experiencing a decline in their balance of trade position in 1969.
4. The *apparel* industries (SIC 23) experienced a dramatic and major deterioration in their foreign trade position, with all but 3 of the 27 industry groups characterized by a balance of trade deficit in 1969.
5. The *lumber and wood products* industries (SIC 24) preponderantly are noncompetitive, with less than a fifth of the individual industries in a trade surplus position.
6. The *furniture and fixtures* industry (SIC 25) suffered a major decline in its competitive position.
7. The *paper and allied products* industries group (SIC 26) has experienced a worsening in its competitive position, with nearly half of the 22 industry subdivisions and the industry

group as a whole persisting in a balance of trade deficit position.

8. The *printing and publishing* industry (SIC 27) is not significantly affected by import competition.

9. The *chemicals and allied products* industries group (SIC 28) has demonstrated increasing strength in its foreign trade position, though the dyestuff and pigment industries as a dramatic exception to that strength have suffered a major deterioration in their noncompetitive foreign trade position.

10. The *petroleum and coal products* industries group (SIC 29) is preponderantly noncompetitive and sustained a major enlargement of its trade deficit.

11. The *rubber and plastics products* industries group (SIC 30) experienced a dramatic increase in its trade deficit, with over two-thirds of the industry subdivisions moving to less favorable trade positions.

12. The *leather and leather products* industries group (SIC 31) is predominantly noncompetitive and suffered a major enlargement of its trade deficit.

13. The *stone, clay, and glass products* industries group (SIC 32) suffered a major shift from a strong trade position to a strikingly large deficit position. Only 11 out of the 38 industry subdivisions included increased their competitive strength vis-à-vis foreign imports.

14. The *primary metal industries* (SIC 33) increased their competitive position on an overall basis, though many sectors of the steel and nonferrous primary industries are in a growing trade deficit position.

15. The *fabricated metal products* industries group (SIC 34) is predominantly characterized by increased vulnerability to foreign competition, though 10 of the 30 industry divisions enlarged their trade surplus.

16. The *nonelectrical machinery* industries group (SIC 35) has many sectors which experienced a worsening of their trade deficit position, a greater number of sectors which saw their trade surplus reduced, but sufficient industry subdivisions which were able to boost their trade surplus to characterize the industry group as a whole as moderately competitive in foreign trade.

17. The *electrical machinery* group (SIC 36) on an overall basis experienced a decline in its trade surplus of major proportions, resulting principally from a very great deterioration in the trade deficit position of the radio, TV, and other consumer electronic product industries.

18. The *transportation equipment* industries group (SIC 37) suffered a major reduction in its trade surplus due to a strong increase in the trade deficit of motor vehicles, especially passenger cars, and a reduction of the trade surplus in other transportation equipment categories.

19. The *instruments and related products* industries group (SIC 38) is strongly competitive, as shown by a substantial increase in the trade surplus, though a number of sectors including ophthalmic goods, watches, and clocks sustained a continued deterioration in their trade deficit position.

20. The *miscellaneous manufacturing* industries group (SIC 39) is predominantly noncompetitive as measured by the number of industry sectors with a growing trade deficit, though the major industry group on an overall basis experienced a strong corrective shift in its deficit balance of trade position.

From this overview it will be seen that nearly two-thirds of the Nation's major industry groups are essentially weak in foreign trade competition, while the other third are essentially strong. Each group, however, has many industry sectors which have the opposite experience from the group as a whole.

The lesson of this assessment is that U. S. manufacturing industries appear by a preponderant margin to be vulnerable to foreign competition. Notably, more than half of all U. S. manufacturing industries are seen to be strongly and adversely affected by foreign competition as measured by enlarging trade deficits and reducing trade surpluses.

Thus, there is a real basis for concern as to the effect of the unregulated importation of goods produced by industries in

foreign nations on employment in manufacturing industries in the United States. With roughly half of U. S. manufacturing industries in a position of increasing vulnerability to import competition, it would seem evident that policies permitting selective regulation of imports will be required if the Nation is to maintain the strength of its manufacturing industries in the domestic market as a source for continued employment and economic growth in the manufacturing sector.

Notwithstanding the lessening of import pressures attributable to the recession in the United States and the stimulation of export demand traceable to the stronger economic conditions abroad, a large number of U. S. manufacturing industries experienced a strong increase in imports and the enlargement of the balance of trade deficit in the products of their industries, market disruption as measured by a substantial increased penetration of the domestic market by imports, and the absolute displacement of workers and the underemployment of their work force as shown by reduced hours of work.

To help you take a closer look at particular industries which have experienced these adverse developments, I invite your attention to the data in Table II. From the 643 industries for which data are presented in Table I, a selection has been made of 110 U. S. manufacturing industries which are being significantly and adversely affected by import competition. These industries and data pertinent to a consideration of their position are shown in Table II.

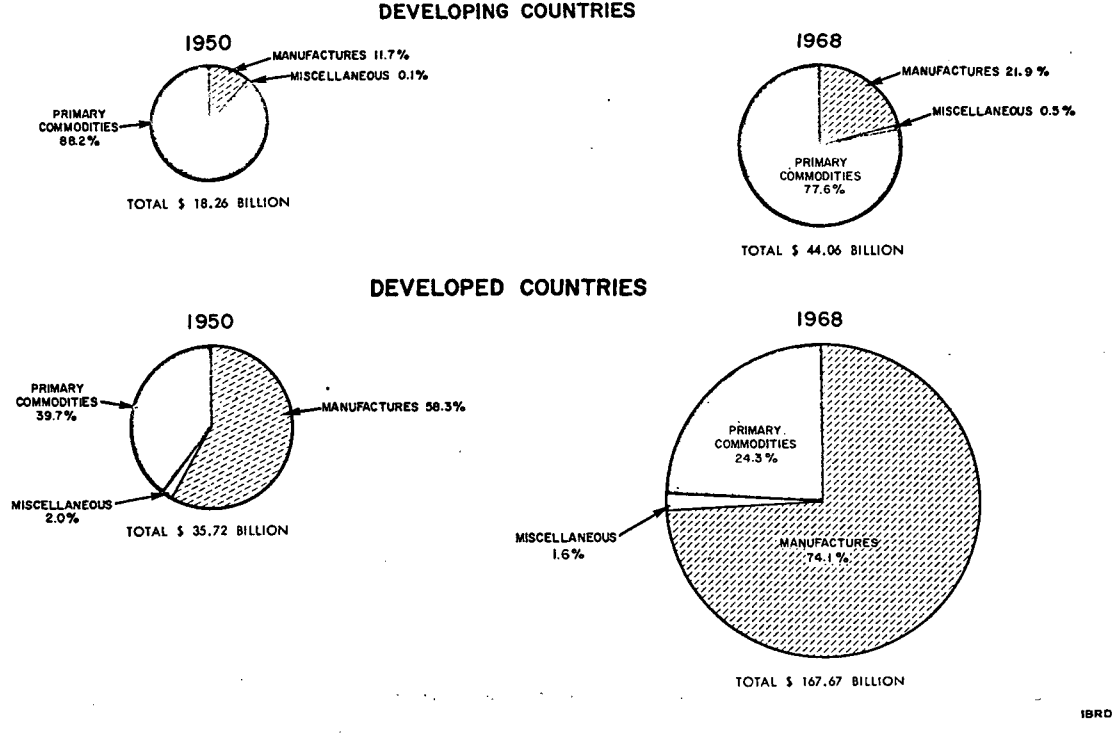
The following points regarding these industries are believed to be significant from the point of view of trade policy consideration:

1. Nearly 75% of the deficit involves U. S. trade with developed rather than the less-than-developed countries.
2. The developed countries accounted for 90% or more of the foreign trade deficit of 63 of the 110 industries; the aggregate deficit accounted for by the developed countries of these 63 industries in 1969 of $7,861.3 million was equal to 59.0% of the total deficit of the 110-industry group.
3. There are only 19 of the 110 industries in which less-developed countries accounted for more than 50% of the total trade deficit; the aggregate deficit accounted for by the less-developed countries in the trade of these 19 industries in 1969 of $3,215.0 million was equal to 24.1% of the total deficit of the 110-industry group.
4. In view of these points, the adjustment of imports to relieve the excessively injurious pressure on the domestic industries would affect the less-developed countries in only a minor way.

This conclusion is emphasized by a consideration of the relative proportion of the total exports of less-developed countries consisting of manufactures. While this proportion has been increasing, manufactures still account for less than 25% of the total exports of less-developed countries, whereas nearly 75% of the exports of developed countries consist of manufactures. This is shown by the following chart.

Chart 4.1

VALUE OF PRIMARY COMMODITIES AND MANUFACTURES AS A PERCENTAGE OF TOTAL EXPORTS, 1950 AND 1968



From: World Bank (International Bank for Reconstruction and Development), *Trends in Developing Countries*, August 1970.

Both from the point of view of the actual composition of U. S. foreign trade in the products of the 110 industries which are seriously impacted by excessive imports, and from the point of view of the composition of the total export trade of other nations, efforts by the United States Government to adjust the volume of imports in the products of these 110 industries to relieve the excessive pressure would primarily affect trade with the developed countries rather than the developing countries.

A study of the data in Table II in relation to employment changes in those of the 110 manufacturing industries for which employment data are available discloses that an increase of employment of less than 2% or an absolute loss of employment during the period 1967-1969 is associated with either a relatively high ratio of imports to new supply in the year 1967, a strong increase in the trade deficit, 1967-1969, or both. This is shown by a recapitulation of such industry data in Table III.

During the period 1967-1969, the aggregate foreign trade deficit of the 52 industries listed in Table III increased by $2,510.8 million. At the value of shipments per worker for the average of all manufacturing industries in 1968, just this increase in the trade deficit of the 52 industries represented the equivalent in output of 81,193 workers. This is reasonably close to the actual loss of employment sustained by the 52 industries during that period of 119,896 workers.

The loss of employment by the 52 industries for which data are presented on Table III is not intended as an indication of the total

loss of employment due to foreign trade by import-impacted industries. It simply represents an indication that for those 52 industries for which complete data were available to permit analysis, the actual job loss was roughly equal to the job loss attributable to the deterioration in the foreign trade position of the industries concerned.

For the entire group of 110 selected U. S. manufacturing industries shown by the 1967-1969 changes in foreign trade balances to be especially sensitive to foreign competition, as presented in Table II, the net change in foreign trade was an increase in the aggregate trade deficit of the group by $5,322.1 million. At the value of shipments per worker for the average of all manufacturing industries in the year 1968, this increase in the trade deficit of the 110 industries represents the loss of the equivalent of 172,103 jobs.

Even this calculation is an incomplete indication of the displacement of employment by the net adverse impact of foreign trade on U. S. manufacturing industries because the group of 110 industries only included those for which complete data were available which were judged to be especially sensitive to foreign competition. Job losses occurred in other industries as well.

For example, the indication of the job loss in the apparel industry presented in Table III does not include the related job loss in the textile mill products industry as a result of the displacement of fabric sales to U. S. apparel manufacturers represented by the competitive impact of imported apparel. Similarly, the job loss shown for the radio

and TV set industry does not include the separate job loss sustained in the industry producing electronic components of the type used in radios and TV's, the market for which is reduced as a result of the increase in imports of the finished items which displaced domestically produced radios and TV's.

When the Congress mandates an increase in the minimum wage through legislation, it is not merely the wage rates at the bottom of the wage structure which are affected, but, rather, the entire array of rates applicable to manufacturing jobs. This has both good and bad consequences. From the point of view of the workers, the upward adjustment of the wage rate structure through the mandated increase in the minimum wage is, of course, a welcome event.

From the point of view of their employers, however, the upward adjustment of manufacturing wages has an arbitrary aspect which is quite disassociated from any increase in productivity which would prevent an inflation of manufacturing costs. The manufacturer has three choices: He can increase the degree of automation practiced in his manufacturing process in order to reduce wage costs by eliminating labor; alternatively, he may attempt to increase prices to cover the increased labor costs; or, he may do neither but simply absorb the increased costs in his operating profit.

Each of these choices is subject to severe constraints. It is obviously not the intention of the sponsors of such legislation to trigger a new wave of automation which would result in a significant

net reduction in manufacturing jobs. Nor could it be the intent of the sponsors to aggravate the conditions which make inflation such an intractable problem for the Nation's economy.

Finally, the great majority of manufacturing corporations in 1970 experienced their worst year from the point of view of profits. Sharply reduced earnings, absolute operating losses, and the collapse of many businesses have been the legacy of the economic recession on manufacturing industries in 1970. Everyone hopes for an upturn, and for many companies the results of the first quarter of 1971 appear promising. Yet it is too early to predict that manufacturing profits will strengthen to such a degree in 1971 as to absorb the increased costs which would result from the enactment of H. R. 7130.

From the point of view of those industries who are especially import-sensitive, the mandated increase in the minimum wage will serve primarily to widen the gap between costs and prices which characterize the unfavorable competitive position of those industries in respect to imports. Therefore, it is a responsible act for the sponsors of the legislation and this Committee to consider the enactment of Title III of H. R. 7130 to provide for a mechanism to protect the workers in manufacturing industries from injury caused by imports manufactured abroad under labor conditions which are below the standard prescribed for domestic producers by the pending legislation.

To help you understand the extent to which manufacturing industries in the United States and their workers would be subject to such injury, I have prepared my final tabulation of industry data taken

from our data bank. In Table IV, I have identified those industries which experienced a net loss of jobs due to foreign trade, ranked in accordance with the degree of import penetration in 1968, the latest year for which the necessary data are available to make such calculations. As you study this list of industries, I predict you will be startled by the following aspects of the listing:

1. There are a very large number of industries who have experienced a net loss of employment due to foreign trade;
2. There is a strong and direct correlation between the depth of the import penetration and the extent of the job loss;
3. Very few of the industries on the list have been the recipient of Government action to bring the excessive imports under control. For your convenience, I have identified in italics those industries which have received some Government assistance.

The data in Table IV demonstrate why it is necessary for your Committee to support measures to protect American workers from the impairment of their standard of living from manufactured goods made abroad under substandard labor conditions, and imported into the United States comparatively free of restraint under the double standard of economic morality to which I have referred.

Please bear in mind that the calculation of the import penetration ratios in Table IV is based on the dollar value of the imports compared with the dollar value of sales in the American market. The use of dollar value as the basis of the calculation understates the import penetration to a significant degree in comparison with the results that would be achieved if each industry's ratio were calculated in terms of the units of imported articles compared with the units sold in the domestic market. Data as to the units are simply not available on a consistent basis in Government statistics; accordingly, we have no choice but to use the dollar value.

In all, there are a total of 132 industries listed on Table IV. The total loss of jobs due to foreign trade in the products of these industries in 1968 was 386,499.

Where the data were available from the statistics of the Bureau of Labor Statistics, I have indicated on Table IV the change in employment of the listed industries between 1968 and 1970. You will find that in most instances the job loss due to foreign trade, measured in 1968, is generally consistent with the absolute loss of jobs which has occurred in those industries between 1968 and 1970.

Mr. Chairman, I believe that the study of the Trade Relations Council which I have presented to you today and the various tabulations of data taken from the study which I have submitted for your further enlightenment in regard to the impact of imports on employment in U. S. manufacturing industries provide the strongest possible foundation for legislative reform of procedures. This concludes my testimony. Thank you for your attention.

BROOKLYN, N.Y., *May 29, 1971.*

Senator ABRAHAM RIBICOFF,
Committee on Finance,
Senate Office Building, Washington, D.C.

(Attention: Subcommittee on International Trade.)

DEAR SENATOR RIBICOFF: Thank you for your letter of May 24th.

Although I had very much hoped to appear personally before the current hearings on America's International Trade Problems in view of the vast amount of knowledge (more easily given verbally than in writing) I had to offer that could easily resolve the current monetary, and balances of trade and payments problems presently afflicting our beloved land, I would vary much like to have my letter of February 7, 1971, addressed to "Letters to the Editor of the New York Times" which accompanied my letter to you of May 12th entered and filed as a formal statement with the Subcommittee.

This letter, as you may recall, was a 4-page affair which included a 2-page postscript and was primarily a response to Senator George McGovern's foreign policy proposal, "An Opening to the Far East," which appeared in the form of a guest editorial in the New York Times of February 5, 1971.

Should you have failed to keep this letter on file or have misplaced it, please let me know and I shall be happy to send you another copy.

In any event, I should like to be informed of my letter's acceptance as a formal statement to be filed with the Subcommittee and which I hope will be read and studied by all members of said committee.

Should you or any other members of the Subcommittee on International Trade, as a result of studying this letter, and after having it filed as a formal statement, desire further information and/or clarification on any of the matters discussed therein, then I shall be most happy to hear from either you or they in this regard as well.

Hoping to hear from you soon, I remain,
Sincerely yours,

ABRAHAM I. KARP.

BROOKLYN, N.Y., *May 12, 1971.*

Senator ABRAHAM A. RIBICOFF,
Senate Office Building,
Washington, D.C.

DEAR SENATOR RIBICOFF: I have read in the May 10th issue of the New York News of your intention to start Senate hearings on world trade issues commencing May 17th with Secretary of the Treasury John B. Connally as your lead-off witness.

Since I have been immersed in the international trade problems of our country over the past ten years by conceiving of sound and practical trade and technological concepts that would have easily resolved and even avoided the current monetary, trade, and balance of payments problems we are currently afflicted with had they been accepted by the previous (and even current) administrations to whom they had been submitted for urgent consideration, evaluation, and adoption, I would like very much to have you personally study the enclosed letter which gives a brief outline of my involvement in these matters.

Should you believe, after studying the enclosed, that my contributions to our government would have been of immense benefit to the continued growth and viability of our economy (thereby enhancing the peaceful and harmonious development of our political, social, and cultural structures as well), then I shall be most happy to volunteer my services as a witness at your upcoming hearings to offer the benefit of my knowledge, skill, and experience in these matters.

Hoping to hear from you soon in this regard, I remain,
Sincerely yours,

ABRAHAM I. KARP.

ENCLOSURE.

BROOKLYN, N.Y., *February 7, 1971.*

LETTERS TO THE EDITOR
The New York Times,
229 W. 43d Street,
New York, N.Y.

DEAR EDITOR: What irks me about Senator George McGovern's proposal, "An Opening to the Far East," (advocating the opening of diplomatic relations and non-military trade relations with Communist China) which appeared on your Guest Editorial Page of February 5th, is that it forms a very minute part of a more ambitious and broadening Marketing and Political Program I had advocated for our American system of Government in early 1961 to the so-called "New Horizons" administration. I even sought to have this new and dynamic trade and political policy emblazoned as the theme of the then contemplated New York World's Fair by appealing to numerous government and private parties to change the then accepted theme, "Peace through Understanding," (a meaningless and trite euphemism) to "Unrestricted World Trade—the New Frontier to World Peace," (which conveyed in concrete and easy-to-understand terms the path to follow in order to attain for our country a dynamic and viable economy through peaceful relationships with all countries and governments regardless of their palitical affiliations and beliefs).

The "irk" comes from the long-remembered fact that the very same type of political activists and opportunists who advocated the economically and politically ruinous "Closed Door" Policies of non-trade (strategic and otherwise) with the entire Communist world in the late postwar 40's and early 50's, are the very ones who are now emerging to advocate the complete opposite of what they had originally foisted upon the American Government and American people under the guise of "protecting us from the Red Menace while at the same time debilitating their energies to spread their doctrine beyond their then present boundaries."

Today, I witness with irony and mixed emotions the resultant downhill trend of our political, economic, and social system (a direct result of these former campaigns of fear and restriction which greatly influenced our foreign and domestic policies) and the political, economic, and social benefits it has accrued for a more cunningly, pragmatic, and deceptive alliance of Western European powers united together under a Treaty of Rome which gave birth to the European Economic Community more commonly known as the European Common Market.

Organized for the avowed intentions of broadening and increasing free trade among the Western World, the European Common Market lost no time in making a complete about face by leaping into the trade void created by America's fear mongers and political demagogues and immediately engaging in commerce with the Communist world in strategic and non-strategic goods and services.

The results of such folly on America's part and of such hypocrisy on Western Europe's part (undoubtedly carried out with the collusion of some highly appointed and/or positioned counsellors, advisors, and career civil servants in Washington) are self-evident.

Whereas Western Europe today, predominantly Italy, West Germany (the original Axis partners of World War II) and France now hold heavily involved trade relations with Russia and the rest of the Communist World in *strategic* as well as non-strategic goods and services which has accrued to them, over the past two decades, healthy economic positions and hoards of American dollars (the most valued currency in foreign exchange) that total in excess of the amount of gold that Washington has on hand for exchange and for backing up its paper currency (in Fort Knox) America's economy, on the other hand, has slid from that of being the wealthiest nation in the world immediately following World War II, to one suffering from chronic reversals in its balance of international payments and trade over the same period of time accompanied by a dwindling gold supply (now less than the amount of dollars outstanding in foreign banks and which must be redeemed in gold on demand in accordance with international monetary and trade agreements), growing unemployment and poverty, wasteful depletion of our natural and national resources in both men and material by pursuing worthless foreign military adventures (another direct result of our repressive foreign policy) and highly exorbitant and non-renumerating showmanship spectacles such as our "man on the moon" project (another

"New Frontiers'" folly) when our highly sophisticated and refined current state of technological art can produce highly innovative and remunerative techniques in marketing and commerce that could easily reverse all these unpleasant trends we are currently suffering from today.

Yes, I am not only "irked," but also "miffed," "piqued," and "revolted" by these tin horn, dime store "messiahs" emerging from the woodworks expousing noble sentiments and presumably omniscient pearls of wisdom that would lead us out of this morass of confusion, frustration, and repression if only we follow them and place them in the seats of power so that they can cancel out the very policies they have advocated over the past two decades that will make them the tin heroes and hollow saviours of America that they truly are.

True, our past leaders of America have been duped by these merchants of fear and repression (who can ever forget the infamous, diabolical Sen. Joe McCarthy of the late 40's and early 50's?) in high and influential posts in our government, but for the electorate to be foolish enough to be duped by them also will only "compound the felony" and bring further disgrace upon the noble principles that this country was founded upon and which appear to be long forgotten in practice by those fortunate enough or dishonest enough to have attained the highest positions in our system of government.

Sincerely yours,

ABRAHAM I. KARP.

P.S. The writer is a Marketing Consultant and Specialist in Applied Technology who has advocated (non-strategic) free trade with all nations in the world community regardless of their political affiliations and beliefs in the full knowledge that only through peaceful trade and commerce can America "build bridges" throughout the world thereby bringing with her goods and services to the common masses and inhabitants of these lands the ideals we cherish most and which enabled us to become as affluent and as generous as we truly are.

The writer does not believe in nor engage in idle slogans or rhetoric, but has translated his beliefs and convictions into practical and concrete marketing concepts that would attain these goals peacefully with dignity and honour for America and her citizens, and has submitted them to past and present administrations as well as numerous government and private agencies for their consideration, evaluation, and hopeful implementation. They are as follows:

(1) CONTAINERIZATION. Conceived of in December, 1960, to help resolve the Government of Israel's then twofold problem of demurrage and the blockade of the Suez Canal to her shipping. Submitted, in February, 1961, to both the Governments of the United States and Israel in the hope of utilizing this new transportation concept (in actuality, an extension of the then popular piggy-back form of commercial railway transportation) to initiate an "Israel Overland Route" that could effectively compete with the Suez Canal and open up a new and alternate trade route for the Western World between the Eastern and Western Hemispheres.

(2) An American "CONVEYOR BELT" System of Transcontinental Containerized Transportation. Submitted this concept to the United States Government in April, 1963, proposing that it be linked up to my previously submitted "Israel Overland Route" Plan thereby providing American industry and commerce with undisputed supremacy in world trade via a globe-girdling system of fast, efficient, and economical containerized transportation.

(3) "Pre-Stowed Hovercraft Carriers." Conceived of this latest concept in intermodal container transportation in Sept., 1967, to prove that America has the technical capability of producing, if it has the will and desire, the most revolutionary means of rapid, efficient, and economical mass container transportation in the world that has the ability to convert the natural isthmuses of the world into natural overland routes thereby eliminating the necessity to build and maintain costly and burdensome waterway canals such as the currently contemplated second Panama Canal. This latest concept also makes obsolescent and out-of-date (before they even get started) the newest concepts of LASH (lighter-aboard-ship) and Seabee barge carriers currently being developed in the merchant marine industry with the aid of enormous amounts of taxpayer's monies from the Maritime Administration of the Department of Commerce.

SPEECH OF O. R. STRACKBEIN, PRESIDENT, THE NATIONWIDE COMMITTEE ON IMPORT-EXPORT POLICY, BEFORE THE MID-AMERICA WORLD TRADE CONFERENCE, CHICAGO, ILL.

THE CHANGING BASIS FOR "PROTECTIONISM"

While the terms, "protectionism" and "free trade" are increasingly decried as obsolete forms of semantics, the evolution of this obsolescence has not been sufficiently uncovered.

The principles of free trade, as elaborated by Adam Smith *circa* 1775, assume a minimum of governmental interference with the market forces both within a country and with its external trade. The term *laissez-faire* (leave alone) has been applied to the economic philosophy of Adam Smith. It underlay the so-called free enterprise system of our own country until the severe depression of the early 'thirties. Essentially it meant minimum interference by Government with business and commerce.

Protectionism, on the other hand, which does represent such interference, was recognized early in our history, particularly after the War of 1812, as necessary if we were to build an industrial nation. Otherwise we faced a future of economic subordination to Britain as a supplier of raw materials and an importer of manufactured goods. The earlist avowed protectonist tariff was the Tariff of 1816.

Thereafter the tariff became a political football, kicked back and forth until 1934. Generally, until then, the Southern States were identified with free trade or a "tariff for revenue only", while the Northern industrial States preferred a protective tariff.

From 1934 to 1967 we engaged in a series of tariff-cutting international conferences and reduced our tariff an average of approximately 80%. Today our tariff on dutiable items is about 10% compared with a little over 50% in the early 'thirties. If the collected duties are averaged over *all* our imports, including those free of duty (some 38% of the total) our average duty is between 6% and 7%. The final reduction of the Kennedy Round will be made January 1, 1972.

THE GREAT DEPARTURES ACCEPTANCE OF NATIONAL PLANNING, EXIT LAISSEZ-FAIRE

The decade of 1933–42 marked a sharp economic-political departure in this country from much that had gone before. *Laissez-faire* economists were driven from respectability into the cemetery of fallen and discredited heroes. National planning of industrial and commercial activity was enthroned as the new god of economic thought. The free enterprise system was de-spurred and tamed. The fame of the British economist, John Maynard Keynes, who had exploit ideas on governmental management of the economy, rose like a shining star over the horizon.

Where *laissez-faire* proscribed or frowned forbiddingly on state intervention in wages, hours of work, working conditions, collective bargaining and similar economic considerations; and was no less appalled over price support of agriculture, reduction of crop acreage and direct payment for non-production, the "New Deal" turned these projudices upside down, and did not stop there. It insisted, in addition, on regulating banks, the stock exchange, railroads, and countering the harshness of the marketplace in displacing workers from their jobs. Unemployment insurance, old age pensions and similar social welfare operations were accepted as legitimate concerns of the Government. Later, public education and medical care became additional claimants for governmental attention. No longer was the marketplace to be the arbiter. *Laisse-faire* economics itself was pickled in formaldehyde and transferred in a bottle to the museum of historical monstrosities.

There was on exception. That was free trade! This theory had so beguiled all who beheld it and all who were exposed to it in all innocence in our universities, that it was divorced by main force from the otherwise blanket condemnation of *laissez-faire* economics where it belonged. Free or freer trade was caressed, adored, smiled upon, cherished, fought for and baptized as a part of the national-planning dogma. "Pale-mouthed prophets" endorsed it and nothing raised the hackles of academic economists more surely than suggestions that a philosophy that had accompanied the development and growth of our economy to the point of world industrial leadership (i.e., protectionism) could not be all bad. Even now 5,000 economists, fair and true, jump to the ramparts when they detect a movement in the dark, which, according to them, is the natural habitat of protectionists. They fire into the forbidding dark at will, which means instantaneously, hoping to inflict mortal wounds on the remnants of the Dark Ages. Recently over 5,000 of them tilted, predictably, against the Mills Trade bill.

FREE TRADE AT ODDS WITH NATIONAL PLANNING

How free trade could survive the tidal wave that swept all other fragments of *laissez-faire* like straw before it, has never been intelligibly or even humorously explained. This phenomenon must stand as a high monument to the cultural lag of the brightest stars in the Milky Way.

Unfortunately for national planning, national planning can be no better than its enforcement. Good plans are discredited and collapse if they are not carried out. Putting them into effect means warding off countervailing forces and turning aside intrusions from the outside that would subvert them.

In this respect the basic barriers to international free trade are today more formidable by far than was the Hawley-Smoot Tariff Act of 1930—that "monstrosity" fathered by selfish interests, a veritable denigration of the Adam Smith *laissez-faire* economic philosophy. This style of denigration must be left strictly to the selection of the national planners who can distinguish between good and evil *laissez-faire*. (Protectionism is, of course, anti-*laissez-faire*, and should have been dear to the national planners, but it is of the *wrong* kind.) It is necessary to be endowed with a special or even mystical insight to detect the distinction. Governmental interference, we must suppose, is of the highest good, so long as it proceeds from the planning centers. Protectionism, although itself an interference, is evidently bad because it comes from the wrong source.

Governmental control of the banks is good. Governmental control of the stock market is good; so also is control of the utilities, establishment of minimum wages; and also control of monopolies, intervention in agriculture, in education, in social welfare.

Times change in all fields and the change, it is held, justifies a modified attitude. A complicated society, it may be agreed, can no longer trust market forces. Selfish interests have insufficient regard for the public good. Therefore they must be regulated: That is to say, all but import trade. Apparently import trade is automatically good and unselfish, and therefore in the public interest.

THE PLANNERS' DILEMMA

Yet, with the advent and far-extension of economic planning, the economic flanks must be controlled if planning is to succeed. If we provide price support for cotton, wheat, dairy products and other farm output the purpose would fail if we did not protect the program on the seaward flank. At one time our Government purchased millions upon millions of pounds of domestic cheese in order to reduce the pressure on prices, only to see it mount in higher and higher tiers in our warehouses, because imported cheese could be bought cheaper. Had this flank not then been protected by import restrictions, the planned rescue of our dairy industry would have collapsed. Therefore these particular restrictions could be justified, particularly by the planners.

Seemingly it was a good interference with the marketplace to help our dairy farms to survive, and this objective justified the bad interference embodied in the restriction of imports. Thus, while protectionism was abominable, it was not the worst thing in the world.

The same observation may be made of our import quotas on raw cotton and on wheat and wheat flour. If the rescue of the farmers was justified, was it an evil act to restrict imports to prevent their upsetting the plan of rescuing agriculture? World cotton and wheat acreage was sufficient to swamp our market with cotton and wheat and depress prices to levels from which we sought strenuously to rescue our growers. Was the one governmental interference good, and the other evil?

In 1946 Congress enacted what has been called the Full Employment Act. It set a goal, a national plan, making the state of employment a national concern.

It follows that if as a nation we adopt a goal of full employment we cannot at the same time be indifferent to forces that if left alone would defeat the plan, whether these be of foreign or domestic origin. To carry out the purpose of the Act the Government has over a period of time utilized the power of taxation, control of money-volume, interest rates and the shaping of the budget as instruments of the policy.

Unfortunately for the success of these various controls, the United States is not an economic island free from foreign influences.

We compete internationally in some sectors sufficiently to be affected internally by the competitive factors of trade. If import competition is not taken into account hand-in-hand with other items in our balance of payments, efforts at tuning the national economy to desired ends may encounter severe turbulence and even overt disruption.

The common disturbing factor from this external source will be found to be the discrepancy in unit cost of production here and abroad.

Our high wage levels are underwritten by escalatiing minimum wage laws and obligatory collective bargaining. These assurances of a high consumer purchasing power were proposed by our national planners and were adopted in the Congress by heavy majorities by the representatives of the electorate over the past thirty-five years. Hand-in-hand with farm price supports, reduced hours of work, and minimum wages, accompanied by high defense expenditures, and, lately, high outlays in the public sectors of social security, education and medicine, we have inevitably increased costs of producing goods in this country at a pace beyond the capacity of our technology to counteract by way of rising productivity. The result was higher prices.

Meanwhile other industrial countries adopted our system of mass production. Their productivity grew rapidly. However, mass production is only half of the American system. Long ago Henry Ford discovered that mass production faced defeat if it were not balanced by mass consumption. Higher wages became inseparably associated with mass production.

The other countries have seemingly not yet learned this lesson. They produce at a volume that is beyond the capacity of the mass purchasing power at home to absorb. This surplus production creates a dependence on foreign markets, as Karl Marx foresaw. The United States is the largest single market in the world and therefore looms as an object of cultivation. Because of the cost discrepancy in a wide range of goods in favor of foreign industry we offer an attractive target for surplus disposal. This is especially true of many varieties of manufactured goods. The foreign cost advantage is magnified in these goods, the more so as the application of labor is extensive. In raw materials the advantage is of lesser degree because less of the lower-wage labor is applied. This fact explains the trend of the post-war mix of our imports. These have gravitated heavily to finished and semi-finished goods as distinguished from raw materials.

With very few exceptions our foreign trade in manufactured goods is conducted with a growing and appalling deficit. Our principal export advantage lies in machinery and transport equipment; and even in that sector it is shrinking.

If we were to revert to a near *laissez-faire* economy, we must first dismantle not only what is left of our tariff but also our minimum wage laws, farm price supports, bank deposit guaranties, social security, stock-exchange control, obligatory collective bargaining, control of interest rates, restrictions on immigration, medicare, regulation of utilities, subsidies of all kinds, including those on aircraft, merchant shipping, shipbuilding and other forms of transportation; but that is not all: other countries must do the same. Not only we but they too must relinquish national economic planning and the network of industrial and commercial controls that support the planning. Not only we but they too must eliminate import quotas, exchange controls, import licensing—and they must renounce currency devaluations, which represent a fertile source of hidden protection, frequently utilized by our overseas competitors.

Of course, even to suggest such a course of action is to underline its absurdity. The trend is toward more controls and regulation, not a relaxation. The interdependence of controls is too well established in experience to sustain any notion of a piecemeal reversion to *laissez-faire*. As an example, full employment depends on the institution of a whole array of other controls.

Industries burdened with rigid costs, as American industry is burdened today, are left with the most limited margin for independent action. If they are exposed to a flanking competition that is not similarly burdened, they are in overt danger of being driven from their home market by imports.

COST OF GREATER EFFICIENCY

If such exposure is widespread any notion of full employment may as well be discarded. The very base of employment is eroded by the need to become more efficient in order to remain competitive. In realistic terms greater efficiency can be achieved only by reducing the work force per unit of production. Employee compensation represents some 80% of production cost, up and down the line (in the absence of windfalls or bonanzas) and therefore greater competitive efficiency can only be achieved at the expense of employment; *and this is not the road to full employment when competitors on the outer flank rob the domestic cost reducer of the greater sales he might expect if the external competition were not there, or were neutralized.*

Insistence on freer access of imports bearing prices distinctly below our own to our market is, to repeat, at odds with the full-employment objective. Other countries know this and act accordingly, through higher tariffs or currency devaluation or other devices to defend their national economies under similar circumstances.

A supreme example of the meaning of the greater efficiency that is constantly urged on our industries as a means of remaining competitive or regaining a competitive position, is found in the experience of the coal industry. From 1950, when the industry was beset by lethal competition from oil and natural gas, to 1965 the coal industry displaced over two of every three coal miners in a desperate effort to become competitive, thus effectively cutting the cost per ton. The industry succeeded at the human cost of 334,000 jobs of coal miners of a total of 482,000.

Should the steel industry, the textile industry, the footwear industry and many others, such as glass, electronics, beef, typewriters, bicycles, small hardware, toys, athletic goods, fruits and vegetables, petroleum, musical instruments handbags, etc.; should all these and others follow suit in desperate efforts to become competitive with imports, we would be swamped with unemployment. The goal of full employment would fade beyond hope of resurrection.

Let us examine the likely results in the steel industry alone. This industry was accused of a technological lag in the early nineteen-sixties. It began spending at a high rate and averaged $2 billion per year in the second half of the decade on capital expenditures. In 1970 nearly half of the steel output was produced by the oxygen process, a more efficient process than the old open-hearth method.

Nevertheless the advance did not succeed in achieving competitiveness, even though in 1969 seven thousand fewer steel workers produced 54.2% more steel per year than in 1965.

To become competitive with imports the steel industry must come much closer to the achievement of the coal industry in point of worker-displacement, as a means of reducing costs. 644,000 was the full employment of the so-called steel industry in 1969. This number, however, produced only 44% of the total value of shipments (if 1967 was a fair sample, the last year of our census of manufactures). This meant that about 56% of the final value had already been produced in the iron and coal mines, transportation services, production of supplies, banking and insurance institutions, etc.

In other words, an additional 720,000 workers derived their employment from contribution to steel-making, of a total of about 1,340,000.

A cost reduction of 20% would displace 260,000 workers. This falls short of the sacrifice in the coal industry, in which, as we have said, some 334,000 miners lost their jobs to higher efficiency.

This calculation provides some idea of the mathematics of rising efficiency in terms of employment. It could be said that these displaced workers will find employment elsewhere. *But where is elsewhere?* If many other industries are equally beset by imports, how is employment to be found for the combined victims of greater efficiency?

Since we still lead the world in productivity per man-hour, it is clearly not superior foreign efficiency that plagues our industries, but their lower wages. Our lead in productivity is indeed narrowing rapidly and we are no longer far enough ahead to offset the lower foreign wages.

Were we in a laissez-faire economy, we would let "nature" take its course. We would put no restrictions on imports but neither would we make federal outlays for the unemployed since to do so would interfere with the free play of market forces. The displaced workers would be forced onto their own resources. Imports would reduce prices to consumers. In a far roundabout way a variety of jobs would open up, some of which the displaced workers might fill. Wages in this country would be allowed to fall as the supply of workers exceeded the demand. Consumers would get the further benefit of lower prices. In a few years of adjustment we would have full employment again—*that is, if we also took down all the other controls that interfere with the free interplay of the market forces.*

The politics of this course of action would, of course, be disastrous to any public leader proposing such a course; and this fact would be known; and the idea would die aborning.

THE REALISM OF PRAGMATIC ECONOMICS AND POLITICS

It is boatless to spin out the theory of free trade because it is a nonexistent entity and lies beyond even the remotest hope of realization. Therefore it is necessary to adjust trade policy to the political realities. These have been enthroned by a generation of legislative effort that turned its back irrevocably on the free market concept in favor of a planned economy.

Some of the realities may be mentioned. This country's share of world exports has shrunk in recent years. From 1960–69 our imports of manufactured goods have risen twice as rapidly as our exports.

With few exceptions (machinery, including aircraft and computers; and chemicals) nearly all other manufactured goods are in a deficit position, and the surplus in machinery is shrinking. The "others" include steel, textiles, footwear, motor vehicles, petroleum, toys, meat, fish, bicycles, pottery, glass, athletic goods, radio and TV sets, nuts and bolts, plywood, tomatoes, mushrooms, strawberries, flowers, crabmeat, copper, etc.

These are the realities we must look in the face as we reshape our trade policy.

As long as we insist on proceeding economically as if two split-levels of disparate competitive forces, one high, one low, can co-exist and trade freely between them, without barriers and controls, we will discredit both the planning and the future hopes of free trade.

Quotas and Prices—A Second Look

(By O. R. Strackbein, President, The Nation-Wide Committee on Import-Export Policy)

Because of some questions raised about the coverage of products that were not included in a previous review of the subject IMPORT QUOTAS AND PRICES—A REVIEW, dated July 6, 1970, issued by this office, a second look is desirable to dispel any doubts about the validity of the conclusions reached in that review.

The United States-Japan Trade Council, specifically, challenged the REVIEW in a 13-page REPLY. In the REPLY the Council mentions Meat, Steel and Peanuts as important products that were not in our REVIEW. The allegation is correct. They were not included.

However, meat is not the subject of an import quota. It is under a ceiling, established in 1964, that would trigger a quota if imports should breach the ceiling. The only time when such a breach was imminent, which was very recently, the ceiling, was lifted slightly to permit more imports.

It may, of course, be argued with some validity that the ceiling has operated as an import quota without invoking the actual administrative burden of an outright quota.

An answer on meat prices is therefore in order.

MEAT PRICES—WHOLESALE

It is true that meat prices have moved upwards since 1964, the year in which the ceiling legislation was passed. The U.S. Department of Agriculture, Statistical Reporting Service, keeps an account of prices on cattle meat, hogs and sheep.

The 1964 average price of beef was $18 per 100 lbs. In June 1970 the price was $28, representing an increase of 55%. The table below shows the price trend from 1964:

Record of beef prices compared with that of hogs (pork)

Hog prices

Year:	Dollars per 100 lbs.
1964	14.80
1965	20.60
1966	22.80
1967	18.90
1968	18.60
1969	22.20
1970:	
January	26.30
February	27.40
March	25.60
April	23.80
May	22.90
June	23.20

Beef prices

Year:	Dollars per 100 lbs.
1964	18.00
1965	19.90
1966	22.20
1967	22.30
1968	23.40
1969	26.20
1970:	
January	26.20
February	27.20
March	28.80
April	28.60
May	27.90
June	28.00

NOTE.—This record of beef prices may be compared with that of hogs (pork).

From these tables, to repeat, we find that beef prices rose from $18 per 100 lbs. in 1964 to $28 in June 1970, an increase of $10 or 55%. We find also that pork prices rose from $14.80 per 100 lbs. in 1964 to $23.20 in June 1970, after having reached a peak of $27.40 in February 1970. The rise from 1964 to June 1970 was $8.40 per 100 lbs., which is to say, 56.7%, or a shade more than the price of beef.

However, at the peak, which was $28.80 for beef in March 1970, and $27.40 for pork in February, beef had risen 60% since 1964 while pork had risen 85% compared with 1964.

Which of the two meat products, beef or pork, it might be asked, was under an import restriction? According to the inflationary theory of import quotas it must have been pork, since the price rose higher than did the price of beef. Yet, it was beef and not pork that was and is under such a restriction.

Thus, while beef prices did rise more than the general wholesale price level and more than other farm products in general, the rise was not as great as that on its companion product, pork, which had no import restriction.

STEEL PRICES

In the case of steel an international arrangement was concluded toward the end of 1968 under which the principal foreign suppliers of this country agreed to limit their exports to the United States. The arrangement took effect at the beginning of 1969.

The item was not included in our REVIEW because the time elapsed since January 1969 is too brief to draw final conclusions.

Nevertheless since the United States-Japan Trade Council raised the question a response is in order.

According to the SURVEY OF CURRENT BUSINESS of July 1970, the whole sale iron and steel price index, where 1957–59 equals 100, stood at 105.6 in 1968, or the year before the export restriction by other countries took effect. In June 1970, the index had moved to 120.2. This was a rise of 14.61 points or 13.9%.

The index for all commodities had risen during the 1957–59 period to 117. Thus the wholesale prices of iron and steel exceeded the rise since 1957–59 by 3 percentage points or 2½%. This is not a serious rush ahead of the general price level, especially when compared with the rise in nonferrous metal prices which jumped from a base of 125.1 in 1968 to 155.0 in June 1970. Among the metals that made up these rising prices were nickel, copper, aluminum, lead. The composite increase was 25%.

Also, the wholesale price of coal far outstripped the price of steel, rising from a base of 107.1 in 1968 to 152.8 in 1970. Coal, as it happens, is an important raw material used in the production of steel.

Yet neither nonferrous metals nor coal have import restrictions in effect.

The price of iron and steel may be double-checked by the price of finished carbon steel. The average price for 1968 was 8.73¢ per lb. By May 1970, the price had risen to 9.74¢ per lb. This was an increase of 11.57%, compared with the rise of 13.9% in the composite price of iron and steel, quoted above. (See Survey of Current Business, U.S. Department of Commerce, July 1970, p. S–32, bottom of page.)

There is nothing in the price trend of iron and steel since 1968 that would support the inflationary charge leveled against import quotas, especially when other metal prices which were not under a quota rose appreciably more sharply, and also coal.

It is reliably reported that prices of iron and steel also rose more sharply in West Germany, Japan, Britain and France than in this country. According to a public statement made by the Chairman of the American Iron and Steel Institute, Mr. George A. Stinson, market prices of steel in West Germany have risen 19% since the inception of the "Voluntary Limitation Program" went into effect; 18% in the United Kingdom, 13% in France and from 15% to 50% in Japan, depending on the product. These increases all outran the price increase of steel in this country.

PEANUT PRICES

Another product that was not mentioned in the REVIEW above referred to was peanuts. The reason for the omission was that the item is not in the item listing provided by the SURVEY OF CURRENT BUSINESS which was the source of most of the other price data tabulated nor up to date in the STATISTICAL ABSTRACT.

However, the Department of Agriculture does report the season average prices of peanuts annually; and these are available through 1969, but not for 1970.

Peanuts are under price support and an import quota limitation. This quota was established in 1953 under Section 22 of the Agricultural Adjustment Act.

The 1953 "season average price" was 11.1¢ per lb. By 1969 this average price had risen to 12.2¢ per lb., or almost exactly 10%. Yet by the 1957–59 price index base currently in use, the wholesale price of all commodities had risen 17% by June 1970. The wholesale price of farm products in general on the 1957–59 base was 111.3 in June 1970.

Since 1953 antedates the 1957–59 price base by several years it is clear that the price of peanuts ran behind the general price level by a very considerable margin, and also behind farm prices in general.

It cannot be properly asserted therefore that the omission of peanuts from the previous REVIEW answered by the United States-Japan Trade Council changed the conclusion from what it would have been had this farm product been included. The experience with peanuts as with the price trend on all the other products that are under import quotas covered under the original REVIEW except dairy products, as noted in that REVIEW itself, supports the conclusion that import quotas cannot be saddled with the objection that they are inflationary.

FURTHER CONCLUSION

What might indeed be said is that one of the prime purposes of our import quota or similar limitation on imports is to prevent a drop in prices to a level so low that it would be disastrous to domestic producers, but that might still return a profit to foreign exporters to this country because of their lower costs.

To say that it is the purpose of quotas to raise prices would be to say that

to date nearly all our quotas have failed of their purpose because most of them have not succeeded in keeping up with the general price level, as demonstrated in our previous REVIEW. They could then apparently be discarded with safety; but that is not the essential purpose of the quota.

However, that the floor under prices might give way because of imports if the quotas were removed, and thus produce an untenable price level for domestic producers, be their product textiles, sugar, petroleum, wheat, peanuts, meat or steel, represents the motivation for such quotas as a preventive measure, rather than a windfall or the possibility of gouging the consumer.

The need for such quotas does not rise in this country but in the foreign countries that enjoy a competitive advantage over us, provided by their lower wages. They need foreign markets because they do not pay their workers enough to buy the increased output of their farms and industries attributable to highly improved technology; and look to us to provide the purchasing power that results from our higher wages.

Import Quotas and Prices—A Review

(By O. R. Strackbein, President, the Nation-Wide Committee on Import-Export Policy)

A constant patter of comment tells us that import quotas will raise domestic prices of the products that are the subject of such quotas.

It should be possible to test the soundness of this unsubstantiated theory. To do so we should trace the wholesale price trends of products that are "protected" by import quotas compared with the price trend in general and the price on particular products that are not so "protected."

COTTON TEXTILES

One of the products that is the subject of an import quota or its equivalent is cotton textiles. An arrangement was made with Japan alone, effective January 1, 1957, whereby that country restricted its cotton textile exports to this country. This arrangement was superseded October 1, 1961, with the so-called Long-Term Arrangement negotiated under GATT. This arrangement covered some 30 countries and about 90% of our total cotton textile imports.

The wholesale price of cotton products (1957–59 equaling 100) was 105.2 in 1968. In 1969 it remained at 105.2 and in October 1970 at 106.7. (Reference: Survey of Current Business, November 1970, p. S–9.)

Once more we encounter a very moderate price rise compared with the general commodity wholesale price-level, which, as we saw, had risen to 117.8 in October 1970. (Reference: same, p. S–9.)

Wool products, which are *not* under quota restrictions, had an index level of 103.7 in 1968, compared with 105.2 for cotton products or only 1.5 below cotton products. The index rose to 104.6 in 1969 but fell to 100.9 by October 1970. Thus there was little to choose between the wholesale price movement in cotton and woolen products. Both remained well below the general wholesale price level. Yet the one was under an import quota or its equivalent while the other was not.

In the case of man-made fiber textile products there was a decline in wholesale prices since 1957–59, accounted for by increased productivity. The index stood at 90.8 in 1968 and moved lower to 85.7 in October 1970.

The downward trend of man-made fiber textile products has been of long-standing. Measured on the 1947–49 base, as compared with the 1957–59 base as used here, the wholesale price in 1959 had already declined to 81.1. This was before imports reached a significant volume. Thus the further price decline on the 1957–59 base to 85.7 in 1970 merely represented a continuation of the cost reduction process that had already dropped prices in the decade of 1949–59 by nearly 20%. (Survey of Current Business, October 1961, p. S–8.)

There is nothing in this record to show that the price of cotton textiles rose as a result of the import limitation. In any event the price increase through October 1970 was comparatively modest, lagging distinctly behind the general commodity wholesale price index.

In a pamphlet recently issued by the United States-Japan Trade Council it is asserted (p. 10) that "Textile Quotas Would Have Slight Benefit but Very High Cost."

"In sum," it says, "proposed textile quotas would be enormously costly to the United States.

"Quotas would accelerate inflation, raising clothing prices to consumers.

"They would boomerang against U.S. export sales and harm the economies of port cities," etc.

Against this cry of alarm, the wholesale price trend of cotton textiles of the past ten years while these products have been under import limitation, stands as a complete rebuttal.

PETROLEUM

A favorite whipping boy of those who say that import quotas raise prices is oil, or petroleum. An import quota was established in 1958, first on a voluntary basis, followed by a mandatory quota, effective March 1959.

The wholesale price of refined petroleum products expressed in an index form, where 1957–59 equals 100 had risen to only 100.3 in 1968 and 101.8 in 1969. A very recent rise carried the level to 103.8 in October 1970.

This compared with an index for all commodities, where 1957–59 again is 100, of 108.8 in 1968, 113.0 in 1969 and 117.8 for October 1970.

"All commodities," of course, include those on which we have import quotas. Therefore it will be desirable to compare the refined petroleum price level with that of other products that are not subject to an import quota. If we select another fuel, namely, coal, which has no import quota and should therefore not be free to move upward in price because it is not "protcted," we find a sharp contrast. The wholesale price index had reached 107.1 in 1968, rose to 116.2 in 1969 and zoomed to 181.0 in October 1970.

Surely if there were an import quota on coal, the quota would be blamed for this runaway price. Obviously other factors were at work.

We find, in other words, that the wholesale price of refined petroleum increased distinctly less than wholesale prices of all commodities and very much less than the price of its competing energy fuel, namely, coal. (For confirmation, see Survey of Current Business, U.S. Department of Commerce, November 1970, p. S–8.)

SUGAR

Yet another product that is under import quota control is sugar. This quota has been in effect antedating World War II.

In 1955 the retail price of sugar was 10.4¢ per lb. Ten years yater (1965) the price was 11.8¢. In 1968 the price was 12.2¢. In 1969 it was 12.4¢ and in September 1970 it was 13.6¢. In 15 years the retail price increased only 30.7% (Statistical Abstract of the U.S. 1970, Table 530, p. 349; and Survey of Current Business, November 1970, p. S–29.) Compare this 15-year increase in retail sugar prices since 1955 with the all-consumer price increase of 36.6% on the *1957–59* base, a 12-year period during which all food prices rose 33.3%—also a period during which public transportation cost rose 73.3%, medcial care 67.6%. Keeping in mind that 1955, the base of our retail sugar price, antedated the index base of 1957–59 by several years, it is clear that the consumer paid distinctly less for sugar in terms of price increase than he paid for consumer goods in general, or for food in general, and much less than for transportation and medical care which were not pinched in point of supply by an import quota.

It follows that the sugar quota also cannot be used to demonstrate that import quotas raise prices unreasonably, or even as much as the rise in other prices.

WHEAT

Wheat is under a severe import restriction that permits less than 1% of domestic production to be imported, in pursuance of a limitation imposed under Sec. 22 of the Agricultural Adjustment Act in 1941.

The price of wheat (hard winter, No. 2, Kansas City) has fallen quite sharply in recent years. The price per bushel was $2.22 in 1950. In 1955 the price was $2.25. By 1960 the price had dropped to $2.00. In 1968 it had sunk to $1.46 per bushel, and in May 1970 it was $1.53.

Corn is not the subject of an import quota. The 1950 price, (yellow, No. 2, Chicago) was $1.50 per bushel. In 1955 the price was down to $1.41. The decline, as in the case of wheat, continued. In 1960 it stood at $1.15; in 1968 it was $1.14 and in May 1970 it was $1.30 (yellow, No. 3, Chicago. The difference from No. 2 is very slight, as note, that in 1968 the price of No. 2 in Chicago was $1.14 while

that of No. 3 was $1.11). (See Statistical Abstract of the U.S., 1969, Table 504, p. 343; and Survey of Current Business, June 1970, p. S-27.)

Comparing the price trend in wheat with that in corn we find that from 1950 to May 1970 the price of wheat dropped 31% while that of corn dropped only 13%. *Yet it was wheat and not corn that was "protected" by an import quota.* The wheat price dropped over twice as much in the 20 years as the price of corn.

Since 1960 the price of wheat dropped from $2.00 per bushel to $1.53 in May 1970, a decline of 23%. The price of corn, by contrast, *rose* from $1.15 per bushel in 1960 to $1.30 in May 1970. This was an increase of 13%. Thus while the price of the "protected" wheat dropped 23%, that of corn which was not under import quota, rose 13%.

In comparison with other commodities the price of both wheat and corn has dropped while the other prices rose rather sharply, especially in recent years.

RAW COTTON

The price of raw cotton has also declined. The decline was greater than that of wheat and corn, dropping from some 36¢ per lb. to some 22¢, or by more than 38%. Yet raw cotton imports are limited under Sec. 22 of the Agricultural Adjustment Act to a quantity less than 5% of domestic production. (Statistical Abstract of the U.S., 1969, Table 505, p. 344.) (There is some difficulty in reconciling the Statistical Abstract prices with those in the Survey of Current Business, but the discrepancy is not sufficient to destroy the value of the comparisons.)

DAIRY PRODUCTS

With a base of 1957–59 equaling 100, the wholesale price index of dairy products stood at 94.0 in 1955, at 105.0 in 1960. In recent years the price rose to 118.5 in 1966, to 127.7 in 1968 and on to 136.5 in October 1970. This was an increase of 30% since 1960, and compares with an increase since 1960 of 24.9% in wholesale price of "Farm Products, Processed Foods and Feeds," which, of course, includes grains, on which the price, as we have seen, dropped considerably and pulled down the average.

Dairy products enjoy an import limitation under Sec. 22 of the Agricultural Adjustment Act, and the price increase has outpaced that of other farm products, as mentioned, but did not outpace wholesale prices of many other products. Dairying has declined quite sharply per capita. Milk produced on farms was less than 1% higher in 1968 than in 1950, despite the considerable increase in population. The number of cows and heifers kept for milk declined by more than 40%. Unquestionably these factors have influenced the price of dairy products much more than the import quota.

The wholesale price of agricultural machinery and equipment on an index base of 100 for 1957–59 rose to 139.5 by October 1970. There is no import quota on this machinery and equipment. Moreover, agricultural implements are duty free! If imports exert such a salutary effect on prices the effect must have failed in this instance.

CONCLUSION

The foregoing recitation can leave little doubt that import quotas have not led to higher prices; indeed, quite the opposite. With the exception of dairy products, with respect to which other powerful factors, such as the public acceptance of oleomargarine, played a large part, causing extensive reduction in dairy herds and in milk output, the prices on products that are "protected" by import quotas have lagged distinctly behind average prices and far behind prices on some other products that were under no import quota limitation.

The cry that the imposition of import quotas would be costly to consumers is unfounded, and those who continue to raise the cry are guilty of misleading the public.

Import Quotas and Tariffs—A Comparison

(By O. R. Strackbein, President, the Nation-Wide Committee on Import-Export Policy)

Import quotas are often compared with tariffs as means of regulating imports. Until recent years this country relied almost wholly on the tariff as a protective device. Other countries, particularly since 1930, have used nontariff barriers rather extensively for this purpose, and import quotas have been prominent among these nontariff barriers.

With the exception of import quotas on a few agricultural products, such as wheat, wheat flour, sugar, dairy products, raw cotton and peanuts, we have had virtually no quotas. Those that we do have on farm products were imposed during the past thirty or thirty-five years, principally to sustain governmental price support programs. It was not until the last ten or twelve years that we established a few quotas on nonagricultural products, such as petroleum products, lead and zinc (removed in 1965), and cotton textiles.

The latter is in the form of international agreements under which other countries agree to restrict their cotton textiles exports to this country. In 1964 we placed a statutory ceiling on the imports of bovine meats but no actual quota. In 1968 an international arrangement was made with the principal iron and steel exporters to limit their exports of those products to this country. The effects are somewhat the same as limitation of imports by quotas.

As our tariffs were increasingly dismantled (some 80% since 1934 on the average), import quotas began to draw more attention from our industries. When the tariff was no longer available while the problems to which it was addressed again loomed large instead of disappearing, a substitute for the tariff was sought.

Those of the freer-trade persuasion now condemn quotas as less desirable than tariffs; indeed brand them as more restrictive and inflexible than the tariff. Now that the tariff is dead, in other words, it finds itself suddenly vested with previously invisible virtues, while the quota draws heavy fire.

The Import Quota

Perhaps one of the principal characteristics of the import quota is precisely its flexibility and malleability. It could be absolute, restrictive and inflexible. On the other hand, it could be liberal, only lightly restrictive and flexible.

Short of an embargo an import quota could indeed place a severe limit on imports. For example, in place of a petroleum quota that permits about 12% of domestic consumption to be imported, it might be 5% or even less, as in some other instances. Such a quota might, moreover, be made inflexible. In that event it might admittedly be more deadly than even a high tariff.

On the other hand, an import quota might be set at a level that would permit a liberal inflow of imports. It could also be devised that in succeeding years imports might be permitted to expand, either in the same proportions as domestic consumption of the product in question, or more or less rapidly, as might be deemed desirable.

The quota would then bear no resemblance to a straitjacket. To describe it as such would represent an effort to discredit it without justification.

The Tariff

The tariff represents a tax on imports either on the basis of value (ad valorem) or by physical specification (so much per lb., sq. ft., ton, or the like and is then called "specific".)

Our tariff is the same toward all nations with the exception of the Communist-controlled countries. This uniformity of the tariff results from the Most-Favored-Nations Clause in our treaties with other countries.

It is oddly enough this very uniformity that represents one of the tariff's principal weaknesses. Competitive levels vary rather widely throughout the world and as a result a uniform tariff is an awkward instrument for regulating the inward flow of trade.

Explanation

Recently TIME magazine carried an article on the international contest for low-cost labor.

While this country has the highest wages in the world there are tiers of lower levels over the whole globe, from the highest to the lowest. Canada, although about 20% below our level, is the nearest to us in point of wages per hour. Europe, although not uniform, is generally higher than Japan while Japan in turn is higher than Taiwan, Singapore, Hong Kong or South Korea. Even in Europe significant differentials prevail. The TIME article says that the Finnish workers have a wage only about half that of the Swedish. German wages are well above those paid in Yugoslavia. To compete with Japan, on the other hand, a German manufacturer is reported to be investing in production facilities in Singapore. Even Japan is seeking low-wage havens in India, Taiwan, Etc. Italy supplies many items to the German, French and Dutch markets where higher

wages prevail. In these many instances it is not the degree of relative efficiency or natural advantage of the soil, climate or the like that principally determines the competitive advantage but simply lower wages.

An equal tariff rate such as we have, applicable to goods coming from all these countries, is no more sensible than having only one size of shoes for all feet. If a tariff were designed against goods from the higher-cost countries, at a level of, say, 15%, the lower-cost areas would enjoy a competitive windfall because such a rate would fall far short of bridging their cost gap. A tariff rate high enough, however, to have a braking effect on the goods coming from the low-cost countries, possibly as high as 100% or 200%, might exclude the higher-cost countries from our market altogether.

Quota Alternative

The import quota avoids this competitive discouragement of the higher-wage-paying countries. The quota prevents the use of the wage-advantage of low-wage countries as a highly effective international trade weapon. It can act as a preventive against the downward pull on wages exerted by the lowest-wage countries against their higher wage competitors.

Quotas can prevent the competitive advantage attributable to low wages from becoming a drag on all efforts to raise wage levels in the low-wage areas.

Quotas and Prices

The notion that import quotas are designed to raise prices is not supported by the trend of prices on products that are subject to import quotas in this country. If anything, there is a negative correlation. In most instances the prices on these products have lagged behind the general price level. (See Import Quotas and Prices—A Review, by O. R. Strackbein.)

This result is traceable to the simple fact that quotas are seldom used, if at all, to raise prices, but to prevent their falling to such ruinously low levels that they would bankrupt our industries while in many instances still returning a profit to low-cost foreign exporters to this country. It is then a defensive rather than an offensive instrument.

This, to repeat, is not to say that the quota could not be used for raising prices. It is to say that it has not demonstrably been so used in this country. The effect of quotas on prices depends on the ground rules under which the quotas are established and the degree of restriction imposed by them. A liberal quota that permits imports to grow in proportion to the domestic market while cutting back current levels of imports little or none at all, will have very little if any effect on prices.

To maintain that quotas raise consumer prices, as a generalization, represents a falsification of historical facts, and is not a service to public understanding of the function of import quotas.

The fact is that import quotas offer the best basis for liberal trade legislation, hand in hand with nondiscrimination, which is a cardinal principle of the General Agreement on Tariffs and Trade.

Eclipse of U.S. World Productive and Competitive Leadership

(By O. R. Strackbein, President, the Nation-Wide Committee on Import-Export Policy)

This will be an attempt in a very abridged form to trace the recent make-over of the American Economy in terms of its competitive capacity in relation to the rest of the world.

In order to find an anchor-point it will be necessary to go back a generation or two. No specific date can be fixed but it is desirable to go back far enough to trace the divergence of our economy from its previous state and particularly from that of other countries, or to about 1900.

The old idea governing wage income was based partially on the iron theory of wages of Ricardo and others. The principal thrust was to get as much labor for as little pay as possible. Wage reductions were imposed as a remedy when business went sour in depressions. In other words, wages were an evil burden on production. Labor could be and was sweated on "sound" economic principle. Legislation and judicial decisions underwrote the practice by keeping unionization under wraps.

New Concept Takes Shape in the United States

After the concept of *mass*-production took hold as a result of mechanical inventiveness in this country, a ray of light of a different wave length broke through. Perhaps the first concrete progeny of this beam of light was the anti-trust laws, in the sense that they reflected the economic meaning of competition versus monopoly power. At the bottom of this distinction lay the interest of the consumer or the people. Competition would bring prices down. Monopoly was bad because it placed pricing in the hands of the monopolists whoever these might be and made of it an instrument of enrichment at the expense of the people.

With this concept the seedbed was ready for another new idea. If mechanical genius was sufficient to speed the wheels of production and swell the stream of goods, the process left to itself was doomed to choke itself on a vast accumulation of products that had nowhere to go.

Example of the Automobile

Folklore has it that Henry Ford was the genius who broke the dilemma. His reasoning seems simple enough; but it was revolutionary if seen as a radical departure from the old wage theory. He saw the need of consumer purchasing power and wages as the life-saver of mass-production. He instituted the $5 per day wage, unheard of at the time. His vision, however, had a yet deeper perception.

Consumer income was not then, as it is not now, all of the same level. How many consumers enjoyed incomes of $25,000 or more?—a tidy sum in Ford's early days. Not very many. If the cost of an automobile was such that only the wealthy could buy it, there was no point in making a great many automobiles. They would only pile up as inventory. The cost per unit would remain high because of low volume of production.

It was obvious, however, that the cost of the automobile could be reduced substantially—how far down no one knew—if overhead were spread over thousands of cars rather than hundreds and as production methods were improved. More yet could be done if hundreds of thosuands of cars could be built; but would people buy them?

If the wealthier elements were buying cars because they liked them, would not the next lower layer of income level also buy them if the cost could be brought within their range? Obviously, the question of chicken or egg sequence faced Mr. Ford. He was allergic to bankers but made the plunge on the strength of his faith in this vision. He sensed that the demand for automobiles was elastic. The farther down he could bring the cost the larger the demand he would encounter. The more cars he produced, the lower would be the cost of each. He could now visualize the bonanza that awaited him if he kept the faith. If there were a hundred who could buy a car at a price of $5,000 and a thousand who could pay $4,000, and a hundred thousand who would pay $3,000, there might be a million who could buy a car at $500.

Mr. Ford operated on this principle and met with phenomenal success. His was the epic of the marriage of mass-production and mass-consumption. He, together with others who saw the same vision, gave to the world the uniquely American system of production and distribution.

The system was not fully understood, as it may not yet be fully understood, but it was viable, albeit there was danger that it might be run into the ground. Indeed a historic crash did occur in 1929. It was only in the next decade that the birthpangs of the twin equation of mass-production-mass-consumption, with much travail, achieved a parturition or actual delivery.

The old idea of wages as a monstrous if necessary evil was nevertheless not easily fended off. It was ready to strangle the new-born idea; but yet the offspring lived and before long was a lusty challenger of the old concept; and in time won the day—some would say, in spades.

The American productive system as epitomized by the automobile brought industrial leadership of the world to the United States. After World War II the other industrial countries were convinced of the virtues of the system as a producer of goods and they fell in line in full cry.

With the help of the Marshall Plan, the infusion of copious capital, and the exposure of thousands of foreign productivity teams to our plants and factories, followed by billions of dollars of private investments abroad by our industries, the other industrial countries moved apace in modern technology and managerial skills. Their productivity, formerly far below that of our industries, was

soon hard on our heels, in a few instances perhaps forging ahead. In some notable instances foreign industries such as steel and textiles in Japan, installed modern machinery and equipment virtually from the ground up industry-wide, while our industries were saturated with machinery ranging from the obsolete, the obsolescent to the modern. This represented a competitive handicap for us.

Other Industries

The example of the automobile did not long remain unique if it ever had that distinction. The principle of cost and price reduction as a means of reaching a mass market succeeded handsomely in other industries that made products for which the demand was elastic. An *in*elastic demand such as we encounter in many essentials, such as salt and sugar, where consumption is limited by the number of stomachs to be fed, does not lend itself to the type of growth and proliferation that supports great industrial expansion.

Demand for the *non*essentials, on the other hand, answers to the old concept of the "indefinite expansibility of human wants." It is in this field that American production has found its widest expansion and intensification. Examples: several cars in a family, multiple radio and TV sets, twenty pairs of shoes in milady's closet.

The "expansibility" of human wants depended for its realization on rising income, such as we have witnessed in this country as it made its way to affluency. Potential consumers could become actual consumers, and the proliferation of nonessential goods became characteristic of our economy of abundance, also one of waste and obsolescence. Such an economy becomes distinctly more sensitive than one that caters only to essentials and little more.

The American economy today is still ahead of other nations in consumer goods. Per capita production and consumption had been phenomenal in comparison with the rest of the world, other than Canada, *but the gap is narrowing.* The technological development of other countries and adoption of our mass-production system poses a threat to us that is yet to be fully perceived or appreciated.

Changed Competitive World

The other countries have indeed adopted our mass-production system, but while their wages have risen—in many instances more than ours in percentage terms, though not in dollars and cents—they continue to lag far behind us (Canada excepted). Their consumers are unable to buy all their mass-produced goods. Therefore they need foreign markets, far beyond our needs, to dispose of their surplus. This country offers the most attractive market, and in 1970 we took $40 billion in goods from other countries. An increase in wages abroad would lessen present dependency on exports. Our economic relations with other countries as represented by trade have changed in a basic sense because of the wage discrepancy. There was a time when the wage discrepancy was less crucial. Our higher productivity acted as a considerable offset. Today that offset is shrinking and in some instances has been lost; and there is another challenge, as we shall see.

The transformation of our competitive standing *vis a vis* the industrially advanced nations can best be appreciated if we place Henry Ford and his vision and endeavors in his day in the present world milieu.

This tour of imagination requires that other industrial countries had been abreast of Mr. Ford in point of automotive technology—i.e., they could in a short time have produced as good an automobile as Mr. Ford. We assume further that his competitors had perceived the meaning of cost-reduction as a means of tapping a broader market, as described herein. At the same time their wages were a half or less of those paid by him. The duty on automobiles, let us say, was 5% if they were imported into this country.

Now, as Mr. Ford, struggled to bring his cost down, so that he could offer his automobile to the public at $1,000, thus hoping to open a wider market, his competitors could have offered this product at, say, $750 or $800! They could also have beaten him to the $500 level.

The envisioned bonanza that became his when he had the market to himself would have evaporated. He could perhaps in those days have reduced his wages sufficiently to contest his foreign competitors' conquest of his market but this step would have violated and subverted his very vision of increasing consumer purchasing power.

Had he been confronted fifty-odd years ago with very low-cost imports he might have opened branch plants abroad to reach into the pools of low-wage labor and exported his product to this country and to other markets from abroad. He might also have licensed foreign producers to produce his car; but whatever recourse he might have had *Detroit would not have become the automobile capital of the world.* The vast employment offered by the automobile industry over the years in this country would have been much smaller. The swelling payrolls of the manufacturers of automobiles, of raw materials and parts and components would not have fertilized the economy, as they did, with gold dust. Our economy would have moved ahead at a distinctly more pedestrian pace.

Add to the automobile industry numerous other rich examples of industries that prospered and proliferated under the American productive system, and the results would have been very different. Had these many other industries also sought to make their way, not under the conditions that actually prevailed at that time but under conditions such as they would have been had the present-day competitive situation, including the advanced state of foreign technology and the lower wages accompanying it, been substituted for the actual one, all would have been different. *The American system would not have become so sharply differentiated during the decades of 1910–1950 from its counterparts in other parts of the world.*

International costs of production would have remained on a much more uniform level. In other words, the differences in cost levels throughout the industrial world would have been comparable to the differences *within* the confines of this country or as they are *within* the borders of Europe itself. These differences would have been bridgeable, and free trade would have been a much more feasible undertaking, even as it has recently been found to be within the European Economic community and in the European Free Trade Association.

Untenable Analogies

However, to seek to equate the discrepancy between American costs and foreign costs with the cost differences *within* this country and thus to minimize the disruption caused by virtually unimpeded imports into this country today, is to overlook the function of comparative dimensions. We have free trade in this country and shifts have taken place in industrial locations (indeed not without some distress, as with the migration South of the textile industry); and Europe is able to come together in areas of free trade, but that is not the same as exposing the high production-cost levels of this country to those of other countries that are armed with our technology, but not with our high wages. Nothing is gained by confusing the two; much is obscured. *Had we started on the same level with other countries, and had the American system been accepted abroad and thrived there, including the concept of high consumer purchasing power as a function of high wages, or had we not adopted our system at all, we would have been close enough together in competitive levels to embark on free trade along with the EEC and EFTA.*

We are, however, farther from that condition today than formerly. With productivity no longer so far apart, and narrowing, but with chasms dividing our wage levels from those of our foreign competitors it is unrealistic to equate our internal competitive diversity with that existing between us and our foreign competitors.

The competitive discrepancy between this country and the rest of the world in a vast array of products has produced precisely the troublous problems that confront us today. We do ourselves no good by minimizing the problem. But for this gaping discrepancy we would not for example, have witnessed the virtual loss of the consumer electronic industry to other countries. We would not now be witnessing the rising threat from synthetic textile imports. We would not see the helplessness of our automobile industry in its efforts to compete against German and Japanese "mini cars", produced at costs we cannot match despite our technology. We would not have witnessed the virtual vanishing of the American-flag merchant marine—down to carrying only 5% of our total imports and exports. As for radio we did indeed for some years enjoy the same fruits of cost-reduction as we did earlier with the automobile. The product was one for which the potential demand was very high, as well as elastic. We needed only to bring the cost and the price down sufficiently to tap the mass market. This was done without benefit of import competition, as it was also done earlier with the automobile. Our technology and business acumen in both instances succeeded in tapping the mass market. We did not need imports as a monitor. Again, much employment was added to the economy by the radio industry.

Then came television, first black and white and then the color version. Before our technology had gone all the way, even with the black and white, foreign sets challenged our progress toward saturation of the market. We were headed off at the pass, so to speak. Sets could be made more cheaply abroad. Our companies then invested abroad and, of course, hired foreign workers rather than American. They licensed foreign manufacturers for a fee, and our economy lost the usual value of patents as generators of jobs in this country. Even the manufacture of radio sets rushed overseas. It was possible to produce sets more cheaply abroad and thus to tap yet lower levels of consumer income in this country and to exploit the market for multiple sets. Once more the increasing employment that formerly would have been ours was lost.

Distinction Between Domestic and Foreign Competition

There exist in superabundance those who insist that domestic and foreign competition exert the same benign influences that bring down costs to consumers. As already noted, we needed no import competition to bring down the cost of automobiles or radios; nor for that matter, to bring down the cost of telephone use. This is not to say that import competition has no effect on prices. If, however, it enjoys too sharp an advantage, the effect on domestic production and employment can be not only erosive but lethal. We have but to reflect on what has happened, not only to consumer radio and television products, but turn our gaze on the sewing machine, watches, typewriters, binoculars, athletic goods, glassware, pottery, tile, footwear, specialty steel, fish and fishery products, some fruits and vegetables, if we wish to behold cripples and wrecks of what were once flourishing industries in this country and healthy employers of labor. There are others; and yet others are waiting in line.

To equate domestic inventions and innovations as disrupters and displacers of labor with the effects of imports is to be hopelessly hobbled by college-implanted mental rigidities over which reality has little hope of prevailing. Workers displaced by technology within this country have always had the hope that the ensuing lower prices would stimulate consumption (assuming an elastic demand) sufficiently to lead in time to higher employment. Not so when imports produce the displacement. The higher employment occurs in other countries, not here. Indeed, investment in our own industries is discouraged.

Moreover, when promising new industries in this country might be expected, as earlier in this century, to open new fields of plentiful employment, face the present-day situation, including instant licensing of foreign production, they would not prosper, but would make a halting beginning and then wither on the vine. They would see their potential market opened to imports to reap the rich harvest that previously was their own. There is then no hope that "in time" new jobs will proliferate over the American landscape.

New Dimensions of the Import Problem

The deterioration of our trade balance in the last decade reflects the results of the developments that have been described. From 1958 through 1970 our share of world exports of manufactured goods has shrunk from 27.7% to 21.3% or by 30%. While we still enjoy an export surplus in a few items (such as machinery and chemicals) this surplus has been narrowing ominously. The high-volume of our machinery exports has, however, virtually destroyed our hope of reaping the benefits of new or "sophisticated" product development. The lead we have in computers, and other "high-technology" products, for example, must be regarded as temporary. *In nearly all other product lines we are in a deficit position. Employment in these extensive deficit lines exceeds that of the handful of industries in which we still enjoy a surplus, by over 2 million.* These deficits did not result from a sudden onset of inefficiency in this country, as is so frequently implied, but from the transformation herein described.

There are those who take great but unjustifiable comfort from the sizeable excess of our returns on foreign investments over current annual capital outflows. This should be no cause for elation since it only measures the competitive advantage available to our capital in the lower wage refuges abroad. The dividends received cannot begin to offset the employment and wage outlays that our economy did not enjoy because of the changed conditions. They merely help to conceal the true competitive disaster we face—through no fault, it may be said, of the industries concerned.

If we can no longer, as it is, count on the growth that follows cost-reduction through higher technology because imports can beat us in efforts to tap mass

consumer income, we must seek means of restoring the conditions that will assure us the fruits of technological progress.

Conclusion

The cost-chasm that separates us from our competitors is deep-seated and structural in nature and will not yield to diplomatic negotiations. The stubborn persistence of the differences is rooted in national economic policies, imposed on industry in the form of controls that are quite inflexible. As a result international competitive forces that might be expected to narrow the cost-gaps are quite thoroughly frustrated, with no end in sight.

The only effective remedy lies in setting ceilings over imports. By holding imports to a reasonable share of our market while permitting their growth as our market grows, nothing is disrupted. New industries and old could then once more look forward to enjoyment of the fruits of their cost-reduction accomplishments. Otherwise our domestic investment climate will not attract, as it did in the past, the infusion of capital needed for growth and higher employment.

We cannot hope under present conditions to achieve full employment except possibly under some unforeseen abnormal conditions. Our market is one of the most open in the world. The few import quotas we have on non-farm products *are noted chiefly for the liberty.* This liberality allows the imports of those few products that are under quota restrictions to loom larger than they would be if the quotas were really restrictive. By being liberal we are made to look illiberal.

The American competitive position in the world has changed basically and radically, but not irreversibly. We must adapt or pay the price in loss of employment and real national income. We must not allow ourselves to become as dependent as was colonial Great Britain, on dividends earned abroad.

TRADE RELATIONS COUNCIL OF THE UNITED STATES, INC.,
Washington, D.C., June 15, 1971.

Hon. ABRAHAM RIBICOFF,
Chairman, Subcommittee on International Trade,
Senate Finance Committee, Washington, D.C.

DEAR SENATOR RIBICOFF: At the outset permit me as General Counsel of the Trade Relations Council of the United States, Inc., to tell you how pleased we are with the establishment of your Subcommittee on International Trade and with your designation as its Chairman.

Under your capable direction and with the formidable knowledge and capabilities represented in the individual and collective talents of Senators Long, Talmadge, Nelson, Fannin, Hansen, and Bennett, we feel reassured that the pressing problems confronting us as a nation in the field of international trade, and crying for solutions, will receive the careful attention they so rightly deserve and require by the Congress of the United States.

This fact already seems self-evident from the contents of your March 4, 1971, report to the Senate Finance Committee, the documents developed by the Subcommittee's staff, and the facts elicited from the hearings conducted during the week of May 17, 1971. We followed these hearings with great interest and are conversant with the testimony presented. Certainly, these initial hearings have been very worthwhile and have served the valuable purposes of identifying, exploring, and relating to our deteriorating trade and payment balances some of the political and economic changes which have been taking place in the world economy. Likewise, they have pointed to the deleterious consequences the lack of an adequate foreign economic policy, if indeed one exists at all, can have on American business, labor, and on the local communities of our nation.

The Trade Relations Council, composed of companies and trade associations which represent a cross section of U.S. manufacturing industry, believes it can make a constructive and substantial contribution to the Subcommittee. As an initial effort, we wish to avail ourselves of the opportunity presented in your announcement of May 10, 1971, and we herewith submit for the Subcommittee's record five copies of a statement, in the prescribed format, for consideration of the members of the Subcommittee.* We consider the statement most germane to your inquiry and it is based on the Council's recently completed third edition, two volume study on *Employment, Output, and Foreign Trade of U.S. Manufacturing Industries, 1958–68/69.* As is indicated in the statement, this report and accompanying tables analyze and vividly portray the foreign trade position

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* See page 837.

of a majority of American manufacturing industries and shows that there was a loss of 408,268 jobs resulting from the net foreign trade deficit in import-sensitive industries.[1] We believe the detailed information in the report and accompanying tables, much of which is not elsewhere available, will assist the Subcommittee by providing a needed factual data base as it proceeds with the more detailed phases of its inquiry.

Your May 10, 1971, announcement indicates that further hearings are contemplated and that persons interested in particular trade problems will be given the opportunity to participate in the review at such hearings. Such being the case, the Council would appreciate being given the privilege of appearing before the Subcommittee at one of these subsequent hearings in the interest of expounding on the attached study and its accompanying statement and to present the views of the Council on additional issues integral to your inquiry.

Again, we compliment the Subcommittee on the comprehensive and penetrating review it is giving to this important matter.

Respectfully submitted.

EUGENE L. STEWART,
General Counsel.

EMERGENCY COMMITTEE FOR AMERICAN TRADE,
Washington, D.C., June 9, 1971.

MR. THOMAS VAIL,
Chief Counsel, Senate Committee on Finance,
Washington, D.C.

DEAR MR. VAIL: I am pleased to submit the enclosed written testimony on behalf of the Emergency Committee for American Trade for consideration by the Subcommittee on International Trade of the Senate Finance Committee.

Along with our testimony, there are a number of appendices, including a current list of the members of ECAT, a compilation of authorities available to the Executive for dealing with unfair treatment of American trade, and a report, "Profile of International Operations of ECAT Members."[2]

The last item was prepared in 1970 to meet a request by a member of the Congress who had received misleading information about ECAT members. Along with other members of Congress, he had received material alleging that ECAT members were enlarging their operations abroad at the expense of domestic production and were depriving American workers of employment while worsening the balance of trade by shipping products to the United States from abroad that could be made here. The enclosed report shows that exactly the opposite is the case. It reveals that the domestic production and employment of most ECAT members have risen much faster than national norms and that the companies collectively make an enormous contribution to the U.S. in trade and payments.

Further work is being done on this report as part of a special research project being conducted by ECAT on the role of American companies with international operations. We would, nevertheless, like it included in your record now because statements have been made before your Subcommittee by witnesses reviving the inaccurate views just mentioned, and ECAT has been singled out in these charges. Even the newspaper advertisement by ECAT members calling for restraint in passage of import quota legislation has been reproduced in the testimony. We believe that the ECAT report provides the facts needed to demonstrate that these charges are baseless.

Since our statement is quite brief, we have not included a summary. I trust this letter will serve as a summary of the appendices and request that it be made part of the Subcommittee's record.

Sincerely yours,

DONALD M. KENDALL, *Chairman.*

WRITTEN STATEMENT PREPARED FOR THE SUBCOMMITTEE ON INTERNATIONAL TRADE OF THE SENATE COMMITTEE ON FINANCE BY THE EMERGENCY COMMITTEE FOR AMERICAN TRADE

The Emergency Committee for American Trade (ECAT) was formed in late 1967 to forcefully express its members' view that international trade and investment are important matters that require national attention. We are pleased that

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[1] The report and tables referred to were made a part of the official files of the Committee.
[2] The list of members and the report referred to were made a part of the official files of the Committee.

this view is so well shared by your Subcommittee and welcome the opportunity to submit this testimony.

For your convenience a brochure listing our members and explaining the purpose of ECAT is attached to our statement.

When ECAT was created, there was a danger, as you will recall, that American trade policy would be radically changed were the many import quota bills than before the Congress enacted. Fortunately, this did not happen.

We continue to espouse care and caution in dealing with trade and investment for there is much ill-informed opinion circulating about in these matters. In your deliberations you will undoubtedly be confronted with diverse and urgent recommendations for totally new policies. These will include the traditional suggestion that imports can be restricted without damage to our exports. You will also be subjected to proposals for placing restrictions on American enterprise abroad that would be considered totalitarian if enacted at home. These and other recommendations will come in forms that sometimes appear to be reasonable. They will also come wrapped in rhetoric about impending disaster should they fail of immediate adoption.

We are convinced that most of these approaches are based on inaccurate economic data, or poor interpretations of the intentions of our trading partners or unwarranted pessimism about the capacity of the United States to thrive in a world of expanding trade and investment.

We do not call your attention to the dangers of precipitate and reckless action in trade and investment policy out of an innocent belief that the present state of affairs is either perfect or impervious to improvement.

In fact, ECAT, from its inception, has called for action by the United States and other leading trading nations to begin work on major changes in international economic relations.

Our goals are plain. We want to see more trade, more American exports, and a larger surplus in our balance of trade. We want to see American investments abroad continue to enhance our economic strength while they benefit others. These investments help support the value of our currency by returning profits and by the fact that they are a tangible American asset worth more than all the gold that was ever accumulated in American vaults.

In our opinion, the testimony that has been presented at the hearings of your Subcommittee has clearly established the fact that thoughtful Americans are worried about our ability to compete in world markets and to obtain equitable treatment from our trading partners.

We believe that the question of the American ability to compete in the world cannot be determined on a narrow basis. Wage rates in America have traditionally been higher than in the rest of the world. Disparities in wages among industrialized countries have been declining quite dramatically in the postwar era on a percentage basis. This trend can be expected to continue, but American exports will have to carry the traditional burden of higher wages for some time. This burden has been an incentive to Americans in the past, directing our energies toward innovation and efficiency, which helps account for our high standard of living as well as our export surpluses.

ECAT has supported measures to restrain domestic inflation, and we consider this effort fundamental to a successful trade policy. We have also expressed confidence in America's ability to profit internationally from innovation and efficiency, and we consider government efforts on this matter also fundamental to success.

The recent moves by the Administration to consider fundamental changes in policy to make American industry more competitive internationally are long overdue.

ECAT will exert its efforts to support the "new look" of the Executive in its efforts to enhance U.S. competitiveness and to help provide business backing for those measures that can do the most good.

Equally important, we would urge efforts to obtain fairer treatment of American exports. In this regard, ECAT has a program of specific recommendations.

The first of these is that unilateral trade restrictions are worse than ineffective in achieving a fairer system. They would, in fact, lead to even more discrimination against American trade and investment and make it more difficult than ever to improve matters.

We are concerned about the difficulties and even disasters that have struck some American firms and workers as the result of their inability to compete with goods produced abroad, usually at low labor costs. We believe in the concept of adjustment assistance and are convinced that the present program requires

the legislative improvements recommended to the Congress by both Presidents Johnson and Nixon. New and more sophisticated and more generous arrangements are needed and should be enacted irrespective of what action is taken on overall trade legislation.

Continuing on the import side of the ledger, we recognize that some foreign competition is sharpened by unfair trade practices. We are, of course, not without remedy in dealing with dumping and subsidies and other shoddy practices. ECAT has prepared a summary of actions that can be taken under existing authorities to deal with these matters. That summary is attached as Appendix A.

In many cases, however, the recourse is a punitive one that may eventually cause another government to abandon an unfair practice, but which does not help the affected American producer. A current case of this nature involves American citrus exports that have been curtailed as the result of questionable preferences given to Mediterranean producers by the European Communities. ECAT has agreed that the U.S. should be prepared to take punitive action against the EC if efforts at a solution fail, even though such action may not directly help American citrus growers.

A more just and less belligerent means of dealing with such problems would be the negotiation of a series of agreements adding up to a "fair competition policy." The goal would be the establishment of reasonably equal competitive conditions for all traders on matters like subsidies and bidding on government purchases. Action along these lines is made even more imperative in our opinion by the need to prevent safety and environmental factors from creating new acrimony and distortions in trade.

ECAT would also like to see more attention given to the so-called "voluntary restraints" on world trade. The United States is, of course, a party to a number of these agreements that exist somewhere between the spirit of GATT and the spirit of Smoot-Hawley. Other nations, we know, are using such agreements to our detriment. The obvious example involves limitations by certain nations on Japanese imports which result in greater pressures on the American market. An international examination of such arrangements could benefit all interests concerned and could include procedures for review and repeal.

ECAT clearly believes that international solutions are the desirable ones for problems of international trade and investment. We are concerned and troubled about the apparent impasse in the search for such solutions. With the revival of the European unification movement, we find American trade interests in jeopardy with no action seemingly being taken to protect them.

Consequently, we would like to see plans for a new series of negotiations that could begin to deal with the matters mentioned in this paper and with the shape of world trade and investment that will emerge after the new accessions to the Common Market.

The United States President would, of course, need Congressional grants of authority to proceed very far in such negotiations. ECAT has recommended that such authorities be accorded and, like improvements in adjustment assistance, it should be possible to move on this front even while other policy reviews are proceeding.

We believe that there was a time in the postwar period when it was quite proper for the United States to subordinate our foreign economic interests to larger considerations of foreign policy. But this time is long past. Foreign economic policy should be framed to meet pressing domestic needs.

With regard to Japanese trade and investment restrictions, we must follow a consistent policy of upholding our international rights under the GATT and the OECD. This would mean pressing *now* for elimination of unjustified import and capital restrictions. Should the Japanese decline such action, then the President should invoke our rights to retaliate in kind—an action that would be clearly understood by the Japanese.

In summary, ECAT is convinced the United States can continue to enjoy the benefits that flow from world trade and investment, that it can hold its own competitively, and that it should vigorously seek and obtain fairer treatment for its exports. These things can be accomplished by positive and confident action and not by a negative reaction to fear.

We have refrained from a discussion in this paper of international production by American and other companies since, as our letter of transmittal explains, ECAT is now engaged in a study of that subject prompted by Congressional interest. The results of an earlier survey on our members' international activities accompany that letter.

SUMMARY OF PRESIDENT'S POWERS TO RESTRICT IMPORTS

Problems	Remedies	Authorities
When a foreign country—	The President can—	Under—
I. Imposes unjustifiable (illegal) or unreasonable restrictions on U.S. exports.	I. Withdraw trade concessions granted the country (raise U.S. duties to their 1930 levels) and for agricultural products also impose quotas.	I. Sec. 252, Trade Expansion Act of 1962, see p. 105.[1]
II. Imposes discriminatory restrictions or charges on U.S. exports.	II. Impose retaliatory higher tariffs (up to 50 percent ad valorem) on foreign imports equivalent to the level of foreign discrimination.	II. Sec. 338, Tariff Act of 1930, see p. 162.[1]
III. Dumps imports on the U.S. market at prices below those prevailing in the country's own market, injuring the U.S. producer of a competitive product.	III. Impose special dumping duty in addition to normal customs duty.	III. Antidumping Act, 1921, see p. 121.[1]
IV. Subsidizes its exports to the United States.	IV. Impose countervailing duty equal to subsidy in addition to normal customs duty.	IV. Sec. 303, Tariff Act of 1930, see p. 147.[1]
V. Interferes with U.S. agricultural price support programs by shipping excessive exports to the United States.	V. Imposes fees or quotas in addition to basic duty.	V. Sec. 22, Agricultural Adjustment Act of 1933, see p. 65.[1]
VI. Engages in unfair competition.	VI. Exclude articles from entry into the United States. to control level of imports.	VI. Sec. 337, Tariff Act of 1930, see p. 149.[1]
VII. Threatens to impair the national security of the United States by excessive exports to the United States.	VII. Increase tarriffs or impose quotas.	VII. Sec. 232, Trade Expansion Act of 1962, see p. 102.[1]
VIII. Seriously injures or threatens to seriously injure U.S. industries by excessive exports to the United States.	VIII. Raise tariffs, impose quotas, negotiate international agreements, or provide trade adjustment assistance to individual firms and groups of workers.	VIII. Sec. 302, 351 and 352, Trade Expansion Act of 1962, see pp. 14, 28–30.[1]
IX. Seriously injures U.S. workers or firms by excessive exports to the United States.	IX. Provide trade adjustment assistance.	IX. Sec. 302, Trade Expansion Act of 1962 see p. 14.[1]

[1] "Selected Provisions of the Tariff and Trade Laws of the United States and Related Materials," Committee on Ways and Means, U.S. House of Representatives, Committee print, June 3, 1970.

Appendix B

Foreign Trade—A Survey of Current Issues To Be Studied by the Subcommittee on International Trade (Pamphlet Prepared by the Staff)

92d Congress
1st Session

COMMITTEE PRINT

FOREIGN TRADE

A SURVEY OF CURRENT ISSUES TO BE STUDIED BY THE SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

MAY 14, 1971

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A SURVEY OF CURRENT ISSUES IN THE FIELD OF FOREIGN TRADE

There are a number of important and often interrelated issues that have arisen in the field of U.S. foreign trade policy. These issues are not academic; they affect the welfare and security of millions of Americans and the well-being of peoples in other nations which the United States' aid-and-trade programs have nurtured and assisted throughout the post-World War II era. This memorandum identifies the issues and the questions which appear to be crucial for an understanding of U.S. foreign economic policy.

STRUCTURAL CHANGES IN THE WORLD ECONOMY—1950–1970

The international economic problems facing the United States in the seventies are significantly different than the issues of the fifties and sixties. In these prior decades, the United States maintained a pre-eminent, though somewhat declining, position in international trade and finance. The economic programs of aid, trade, and foreign investment incentives pursued by this nation during that period were aimed at providing for the transfer of real resources, first to war-torn countries of Europe and Japan, and then to "developing countries" of Asia, Africa, and Latin America.

During this twenty year period, however, the United States sustained balance of payments deficits in every year but two, and its international financial position deteriorated substantially. At the same time, economic power blocs developed in Europe and elsewhere, Japan became the third most powerful industrialized economy, and the United States share of world trade declined.

In the last quarter of this century, Europe is likely to consolidate into a large economic bloc of nations, encompassing over half a billion people and with a gross national product as great, if not greater than that of the United States. If Japan maintains its traditional growth rate, it will become the foremost industrial power in the world, particularly in basic industries such as steel, heavy machinery and electronics. In a word, the United States will be facing a severe test of maintaining competitiveness in manufactured goods.

Decline in World Trade Position

Though the United States is still by far the World's largest trading nation with exports and imports aggregating over $80 billion, its position vis-a-vis major trading nations and blocs of nations has declined, as has its share of world trade. The U.S. share of world exports declined from an average of 23 percent in the 1950–1957

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period to 20 percent in 1958–1964, 19 percent in 1964–1968, and 16 percent in 1969–1970.

It was natural and expected that our share of world trade would have declined during the fifties with the economic recovery and rapid growth in Europe and Japan. However, the continued deterioration in the U.S. trade position during the sixties is not a natural consequence of postwar recovery, but appears to be a reflection of fundamental structural changes in the U.S. and the world economies.

Our trade balance, another customary means of measuring competitiveness declined from an average surplus of $5.4 billion from 1960–1965 to an average of $2.5 billion from 1966–1970. Actually, if measured to exclude foreign aid-financed exports and to include the cost of insurance and freight in our imports, our trade position would show an average deficit of about $4 billion in every year since 1968.* The c.i.f. basis of measuring imports, used by over 120 nations, is a better indicator of the effects of imports on the domestic economy—production and jobs—than the f.o.b. system used by the United States and a dozen other countries. Not only are the U.S. import figures misleading but the statistics on U.S. foreign trade cannot be compared with existing production and consumption data because of noncomparable statistical classifications.

The United States economy has become service and defense oriented; consumer goods production of watches, radios, televisions, clothing, and shoes is shifting to low-wage countries abroad. In some respects the "consumer" benefits from cheaper products. Imports not only serve to provide the consumer with a wider variety of goods to choose from in terms of price, quality and service, but also serve to assuage price inflation in domestically produced products. But, intensive import competition and the emigration of U.S. firms to foreign lands does cause displacement of U.S. production and jobs.

The consumer must also consider the effect of a growing dependence of imports on price and servicing. Once imports capture a substantial share of the U.S. market, foreign producers can easily increase prices and the consumer advantage tends to diminish. Also, owners of foreign products—automobiles for example—often have difficulties in getting spare parts and adequate servicing.

While large firms, with mobility of capital and management can often adjust to import competition, by going abroad for example, the inability of small business and of the U.S. labor force to adjust to these changes is a major problem.

This is where the theory of "comparative advantage" breaks down. The theory assumes complete mobility of labor, capital and management across international boundaries; it also assumes no government interference with free market forces and flexibility of exchange rates. In reality, labor is not mobile internationally, markets are not free from government interference and exchange rates are relatively fixed. Without the underlying assumptions being correct, the theory cannot and does not serve as a useful guide to the policy makers in any country. Its real acceptance appears limited to academic circles.

*See table 2 in appendix.

3

Structural Changes

The rapid internationalization of production fostered by multinational firms; the transfer of technology; the consolidation of common tariff and other policies in economic power blocs; the sharp increase in agricultural production abroad stimulated by high support prices and repressive import policies; and the dramatic economic growth in Japan, and that country's drive to expand its world market share while protecting its home market—are all important structural changes in the world economy which have played a large role in the deterioration of the international economic position of the United States in the sixties and are likely to continue to do so in the seventies and eighties. Some of the more philosophical questions which these structural changes raise are:

(*1*) *What are the economic and human costs and benefits of these structural changes in the world economy?*

As a nation we have run continual deficits in our balance of payments since 1950. As a result, our short-term liabilities to foreigners have risen from $7.6 billion in December 1949 to $43.7 billion as of January 1971. Liabilities to official institutions directly convertible into U.S. gold now total $20.5 billion. Our gold stock, meanwhile, has fallen from $25 billion in 1950 to $10.7 billion in 1971.

The unemployment rate in the United States is now over 6 percent of the labor force. Imports are a contributing factor and particularly hit the semi-skilled, immobile worker in labor intensive industries.

(*2*) *What policies should the United States adopt to meet the needs of the last quarter of the twentieth century?*

In the light of all that has taken place in the world economy it is somewhat surprising that few new ideas or initiatives have been proposed which can reverse the decline in the U.S. international competitive position. For example, no concrete negotiating plans have been presented to the Congress since the end of the Kennedy Round. It would appear that the policies of the fifties and sixties on aid, trade and investment require an overall reexamination together with a reordering of priorities, to meet the needs of the seventies.

(*3*) *Does the persistent U.S. balance of payments signify that the U.S. dollar is overvalued vis-a-vis other currencies such as the yen and the mark?*

Japan's international balance of payments is strong. It has a large balance of trade surplus with the U.S. (averaging between $1–$1½ billion since 1968) and also earns considerable foreign exchange from offshore U.S. military expenses. The parity of the yen (of 360 yen to the dollar) was established on April 25, 1949, and certainly Japan's economic condition has changed dramatically since then. An upward revaluation of the yen would improve the U.S. competitive position vis-a-vis Japan.

The current monetary crisis in Europe reflects, in part, a fundamental disequilibrium in the exchange rate structure.

The German mark, twice revalued since 1958, still appears to be undervalued in relation to the dollar. The basic choice is between a revaluation of the mark (and other currencies, such as the yen) or a devaluation of the dollar. Since the dollar is still the world's key currency to finance trade and other transactions, and since all other currencies are effectively "pegged" to the dollar, a dollar devaluation could be disastrous to the world economy.

Finally, it is not sound economics to separate into distinct categories "monetary" problems from "trade" problems; the tendency of all nations to "compartmentalize" their problems is a mistake.

(4) *Is the significant decline in the U.S. competitive position in many industries due to short-term or long-term causes?*

This is a broad question but the answer is important. If the decline in the U.S. position, say since 1965, is due to the inflationary pressures in the economy stimulated in part by the Vietnam war, then one could reasonably expect with the cessation of hostilities a restoration of the healthy trade surpluses we had between 1960–1964. If, on the other hand, the causes are long-term and structural, the U.S. will need to take strong action on import and export fronts to restore a healthy trade surplus.

(5) *Should the activities of multinational corporations be guided by national economic goals?*

Multinational corporations have the ability to shift capital from country to country to take advantage of interest rate incentives, or prospective changes in exchange rates. They can also encourage countries to provide tax and other advantages for plant locations which could encourage dislocations in other countries.

The recent monetary crisis is due, in large measure, to massive shifts of short-term capital—mainly Euro dollars under control of multinational corporations and commercial banks abroad—into Germany. The press has reported that nearly $2 billion flowed into Germany in the period of a few days. The multinational corporations can shift large sums for interest rate gain, or in anticipation of currency revaluations. Such massive shifts can actually force currency revaluations, and are dangerous to international financial stability.

(6) *What steps would be needed to reverse the decline in the U.S. trade position relative to those of our major trading partners?*

A number of steps appear to be necessary. Some must be taken in concert with other nations. These include: (a) equitable international rules on subsidies and border tax adjustments, (b) flexible exchange rates, and (c) adoption of an "open door" policy by countries in balance of payments surplus such as Japan. Others can be taken by the United States unilaterally. These include: (a) provisions for temporary tariff or quota relief to injured industries and firms, (b) an overhaul of adjustment programs to retrain workers and place them in higher paying jobs, and (c) a much tougher

negotiating posture using all the leverage that the U.S. has with respect to Europe and Japan.

(7) *Are these steps compatible with existing international obligations and the U.S. position in the world economy?*

Most of these steps outlined above are, but there is also a need to restructure existing rules and institutions to fit the changed economic conditions in the world economy.

Increased Import Competition

U.S. imports have grown from $5.1 billion in 1946 to $13.0 billion in 1958 to over $40 billion in 1970.[1]

During the sixties alone, imports more than doubled and, in many industries, have accounted for a growing share of domestic consumption. Industry and labor spokesmen have expressed concern over; this trend and fear that it is irreversible.

The Executive branch and other free trade advocates contend that the people employed in such "inefficient" industries should "adjust." But adjust to what? Can an unemployed steel, textile, shoe, or electronics worker be retrained to manufacture computers for aircraft? Or, does adjusting mean he (or she) should move abroad with U.S. corporations to work for 8 cents an hour in Korea, or 12 cents in Taiwan, as the "comparative advantage" theory would suggest. What industries are there in the U.S. which, on their own—without government support—will be viable entities in the seventies capable of employing large numbers of semi-skilled or even skilled labor? These are a few of the key questions on import problems; others appear to be:

(1) *What should the government do, if anything, to help industries, firms, and workers besieged by severe import competition?*

Article XIX of the GATT permits a country to impose import restrictions on products of industries seriously injured by increased imports, while Article XII of GATT permits the use of quotas to protect a country's balance of payments position. Thus there is sufficient flexibility on these scores for the U.S. to take action against excessive import competition.

But the U.S. "escape clause" law on providing relief to injured industries, firms, and workers is admittedly so rigid that few have qualified, except for "adjustment assistance" which many feel is a glorified name for "funeral expenses".

(2) *Should government aids to industries, firms, and workers injured by imports be any different from such aids to any injured industry, firm, or worker irrespective of the cause?*

This is a philosophical question. An unemployed steel worker hit by automation is just as unemployed as a steel worker laid off because of imports. Why should the Federal Government discriminate in the treatment of two equally-disadvantaged citizens? Furthermore, as a practical matter,

[1] U.S. imports are generally measured on an f.o.b. (freight on board) basis. Most other countries measure their imports on a c.i.f. (cost, including insurance and freight) basis which adds about 10% on the average to the f.o.b. figures.

it is difficult to segregate causes of injury in a highly competitive and fast moving economy.

(3) *What kind of education, retraining and "adjustment assistance" would be necessary to shift employment displaced by imports to more lucrative and competitive areas?*

We do not know, for example, what the employment characteristics are of those laid off because of imports, including age, location, education and earning power. Answers to these questions are necessary if intelligent policy is to be set. The Department of Labor should undertake studies to provide these answers.

(4) *What are the human and economic costs of such a program?*

The AFL–CIO estimates that 700,000 jobs have been lost to imports since 1967 while 400,000 have been gained by exports. What jobs? How do we reverse this trend?

These questions have not yet been answered by those who suggest U.S. labor should "adjust" to import competition.

Obstacles to U.S. Exports

U.S. exporters have also raised a hue and cry over foreign tariff and nontariff barriers. Since 1934, the United States has entered into numerous negotiations to reduce tariff barriers with other countries.[2] By and large we have succeeded in reducing the tariff to a secondary position as a trade barrier although for many countries, and even for some U.S. industries, the tariff still affords important protection. There also are large tariff disparities in many products. For example, the U.S. tariff on automobiles, after the Kennedy Round cuts, will be three percent ad valorem, while the Common Market and Japan will have tariffs of 11 and 17.5 percent ad valorem, respectively. The Canadian duty on automobiles is also 17.5 percent, in spite of the U.S.-Canadian Auto Agreement, which was billed as a "free trade" agreement in automobiles for the North-American market.

Nontariff Barriers

"Nontariff barriers," a term which covers a multitude of protective practices and procedures, have replaced the tariff as the principal protective device for many countries. These so-called "NTB's" vary from outright *embargoes* to the purposeful or inadvertent results of health, safety, and more recently antipollution requirements. "NTB's" are often exceedingly difficult to identify, and no one has ever attempted a major multilateral negotiation to swap off "nontariff barriers" in a tit-for-tat fashion. Yet their effects have been to hamper the growth of U.S. exports, while U.S. imports predictably rise in the face of a general lowering of tariffs.

[2] The Kennedy Round, the sixth multilateral tariff and trade negotiation, resulted in an average U.S. tariff cut of 35 percent, or 4.2 percentage points, from a level of 12 percent to a level of 7.8 percent.

(1) *In the light of the importance of foreign nontariff barriers to U.S. trade, how should the Congress and the Executive proceed to deal with them?*

(2) *What kind of negotiating authority is needed by the Executive to negotiate in this difficult area?*

Because of the Constitutional system of checks and balances, the Congress cannot negotiate with foreign nations and the Executive cannot change U.S. law by entering into a treaty or international agreement. Many NTB's are written into the statute books, so that a U.S. trade negotiator cannot "commit" the United States Government to a change in laws. However, these limitations indicate the necessity for the two branches to cooperate in the development of comprehensive rules of free and fair competition for international trade. When such potential rules are formulated, it would then be possible for the Congress to grant limited, but meaningful, authority to the Executive for negotiating these barriers.

(3) *In this regard, should a general statement of Congressional intent, such as the one sought by the Executive in the Trade Act of 1970, be the legal basis for negotiating NTB's?*

Probably not. A general statement of intent is an insufficient guide to any negotiation and the Congress is more likely to balk at the results than if a clear, specific authority were sought by the Executive.

(4) *Which NTB's are negotiable and which are considered nonnegotiable?*

This question should be studied by the Executive and the results made clear to the Congress before authority to negotiate is sought.

(5) *Can one deal with nontariff barriers better through multilateral negotiations or through bilateral negotiations?*

It would be extremely difficult to swap NTB's with all GATT members in one big multinational negotiation.

Perhaps individual country negotiations are more promising and the benefits could be extended to third countries only on a *quid pro quo* basis.

(6) *Do nontariff barriers lend themselves to "sector negotiations" such as an NTB steel, textile, or aluminum sector negotiations?*

Some NTB's will lend themselves to sector negotiations; others should be negotiated on their merit since they affect many industries and products.

(7) *How does one identify the trade distorting effects of various nontariff barriers?*

For example, what effects does the common agriculture policy of the Common Market, or the import licensing of Japan have on U.S. trade?

These are but a few of the difficult questions which must be resolved before the Congress and the Executive can tackle the difficult NTB problem. To date, however, answers are still lacking.

Balance of Payments Strategy

Foreign trade has not yet been affected directly by U.S. balance of payments strategy, at least so far as private transactions are concerned. (Foreign aid has been tied to U.S. exports, but the government is moving away from the tied-aid policy.) But, time may be running out to preserve trade in such a sacrosanct position. Already, the United States has imposed a rather comprehensive system of capital controls through the Interest Equalization Tax, the mandatory direct investment program, and the "voluntary" bank-lending program. Although these devices have been in effect for several years, they have not been sufficient to eliminate balance of payments deficits which reached an all-time high of $10 billion in 1970, and has been reported to be running at twice that amount during the first quarter of 1971. If free trade is supposed to give rise to the most "optimum level of efficiency" in the utilization of resources, does not the free movement of capital, particularly equity capital, tend toward the same end? The answer would seem to be yes, but for various reasons, this nation has chosen to control investments abroad rather than imports.

Investment abroad, particularly equity capital or "direct" investment ultimately earns considerable foreign exchange for the United States in the form of repatriated earnings, royalties, and management fees and related or induced exports. If the balance of payments problem of the United States were truly a short-term problem then "temporary" capital controls makes sense. But a problem that has been with us in 19 out of the past 21 years can hardly be deemed "short term" and, to that extent capital controls are self defeating in that they cut off future earning power.*

In contrast to investment, current consumption of imports is an out-of-pocket expense which brings no future rewards from a balance-of-payments standpoint. Thus, the question is raised: "Are we being consistent or rational in espousing the virtues of 'freer trade' while clamping down or attempting to clamp down, on the free movement of capital across national frontiers"?

Foreign nations, particularly in the European Common Market, have been lecturing the United States to eliminate our balance of payments deficits for years. However, judging by their vocal response to U.S. attempts to reduce our military expenditures in Europe, or to moderate the influx of imports from Europe, or to tax American tourists going to Europe, it would appear that they want us to solve our balance of payments problem in a manner calculated to serve their best interest rather than our own. Their favorite remedies are to persuade us to raise interest rates to the point of depressing our domestic economy and causing difficult unemployment problems or to control our investments in their market.

Is the proper U.S. response to this schizophrenic attitude of our European friends to our balance of payments problem, the one recently suggested by Secretary Connally—"To pull out our sixth fleet from the Mediterranean and let the Europeans arrange for their own defense"? (Quoted in the Washington Post, April 26).

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*See table 10 in appendix for balance of payments deficit

9

CHANGING POWER BLOC RELATIONSHIPS

U.S. Trade Relations With the European Economic Community

The European Common Market—a full-fledged customs union with a common external tariff, no internal tariff, and an attempt at "harmonizing," fiscal, monetary, antitrust, agricultural, and other policies—poses a major challenge to U.S. foreign trade policy. The common agricultural policy of the European Economic Community has become highly protectionist and has adversely affected U.S. trade in one of the few areas where we have a comparative advantage. U.S. exports of agricultural products subject to the European variable levy system declined by 47 percent between 1966 and 1969, resulting in a loss of hundreds of millions of dollars worth of U.S. sales to that market. There was some improvement in 1970, but mainly in goods that are not subject to the variable levy.*

Also, the European system of taxation, with border tax adjustments and export rebates, constitutes a formidable obstacle to our exports and an unwarranted inducement to exports from the EEC. It is expected that the Europeans will establish a common 15 percent border tax (in addition to tariffs and other barriers) on imports from nonmember countries, and the same amount of tax rebate on exports to nonmember countries. This will provide an effectively higher level of protection for many European industries than the level existing before the Kennedy Round. There are also European government procurement restrictions and hidden administrative barriers which U.S. industry has complained about bitterly.

Foreseeing that the European Economic Community could evolve into a highly protectionist bloc and wishing to build a "partnership" between the United States and Europe by increasing their economic interdependence, the Trade Expansion Act of 1962 was proposed to break down Atlantic tariff barriers and to encourage British entry in the hope of making the Community more "outward looking".[3]

Having concluded the Kennedy Round, acclaiming it as a grand success, even our negotiators may have been shocked to discover that the U.S.-EEC economic problems after the Kennedy Round were greater than before. Industry complained that the Europeans increased their nontariff barriers as they reduced their tariffs and agricultural interests complained that the Kennedy Round did nothing to even soften the highly protectionist EEC common agricultural policy. Europeans, in turn, began to view direct investment by foreigners (mainly the United States) in basic industries with a jaundiced eye.

Our policy appears to ignore EEC protectionism while cooperating with them by discouraging U.S. investments in Europe on balance of payments grounds. In the meantime, the U.S. maintains and supports over 300,000 American troops and twice that number of dependents in Europe to protect the Europeans (and ourselves) against Soviet bloc encroachments. In 1970, defense expenditure accounted for 8.9 percent of our GNP; in France the figure was 4.7 percent, in Germany

[3] Section 211 of the Trade Expansion Act, gave the President authority to cut U.S. tariffs to zero on those commodities in which the United States and the EEC together accounted for 80 percent or more of world trade. Without British entry this provision became worthless.

*See table 6 in appendix for U.S.-EEC agricultural trade from 1965–70.

3.9 percent, Italy 2.9 percent, and in Japan 0.8 percent.* The West Europeans are doing a flourishing business of trading with the countries which we are spending billions to protect them against. The U.S. trade with Eastern Europe totaled, in both directions, $444 million in 1969; the rest of the "free world's" trade with Eastern Europe in that year totaled $16.6 billion.** There is something nonsensical in all this.

Since the Kennedy Round, threats and counterthreats have reverberated across the Atlantic on trade matters. Thus, ironic as it may seem, the Kennedy Round which sought the elimination of trade barriers, may only have served to sharpen the trend toward protectionism in both Europe and the United States.

Negotiating With the EEC

How to deal with the EEC as a negotiating entity remains a problem of major proportions. The Community must get the approval of all six nations before acting. The countries still have disparate interests and this has often hampered the ability of Community spokesmen to present a realistic proposal for the bargaining table. This was very much evident in the Kennedy Round, when the Europeans kept U.S. negotiators waiting for almost three years while they worked out a common agricultural policy which was highly restrictionist.

British Entry

If the British enter into the European Common Market, followed by other European countries such as Austria, Denmark, Sweden, Switzerland, Ireland, Norway, and Finland, the resulting bloc will create an entirely new situation for U.S. policy makers. The enlarged European Common Market, with as many as fifteen full members and spreading its tentacles of special commercial arrangements with Mediterranean countries, former Commonwealth countries, and others could radically alter the economic balance of power. Those who speculate that British entry will somehow make the EEC an "outward looking" bloc may well be engaged in wishful thinking, and the history of the EEC suggests that such speculation would be risky. If six countries can't easily agree on a realistic bargaining position, how can we expect upwards of 15 countries to do so?

How do we cope with the bargaining strength of an enlarged economic power bloc the size of all of Western Europe, which has the power to convert their dollars into gold every time we act to defend ourselves against excessive competition in labor intensive industries? These dollars are "earned" by the Europeans, in part, by U.S. military expenditures in Europe and elsewhere.

U.S. Economic Relations With Japan

Japan has shown the fastest and most sustained economic growth rate of any major country during the postwar period. This has been an economic miracle which merits the acclaim and the wonder of Western man, and is a testimony to the skills and drive of the Japanese people.[4]

[4] The Japanese economic growth rate has averaged more than 10% a year for the last ten years and its exports have grown at a rate faster than that of any other industrialized country.

*See tables 8 and 9 for defense expenditures by country.
**See table 4 for Free World trade with Eastern Europe.

At the same time, however, the Japanese economy, internally and externally, is highly controlled. Few American corporations have been allowed to set up wholly-owned subsidiaries in Japan and imports are rigidly controlled by quota and licensing arrangements as well as by bureaucratic red-tape. Thus, while Japanese exports of textiles, consumer electronic products, cameras, steel, motorcycles, and automobiles have flooded the U.S. market, American producers have been denied access to the rapidly growing Japanese market. Japan has set up wholly-owned subsidiaries and trading houses to handle their exports. Japan has been able to concentrate its efforts in the expansion of commercial markets because only 7.2 percent of its budget is spent on defense (compared to 37 percent in the U.S.) and only 0.8 percent of its GNP is defense as compared to 8.9 percent in the U.S.*

The United States for years has sought to persuade Japan to liberalize its controls over investment and imports, and the Japanese have reduced the number of import quotas but they still retain quotas on many important products and a comprehensive system of import licensing. Japan is out of character in seeking to preach the virtues of free trade to other nations.

The United States has asked Japan to restrain voluntarily its exports of woolens and man-made fiber textile and apparel products to this market. Through bilateral agreements with many European countries and Canada, Japan has restrained her exports to those markets. Because of the closing of these markets to Japanese textiles, the United States now absorbs over 50 percent of Japan's textile and apparel exports while Europe absorbs about 5 percent. The U.S. textile industry seeks relief from discriminatory arrangements, the results of which have been to channel Japanese textiles into this country—the last major market still open to them. While to some, this may appear to be an unjustified request and an aberration from our "free trade" philosophy, the fact is that we are the only importing country of any size which does not have restraints on imports of wool and man-made fiber products through bilateral agreements or through import quotas. The Europeans talk about the dangers of U.S. protectionism but they are already protected and are quite content to have the U.S. absorb the bulk of Japan's exports of textiles. The textile issue must be resolved before any meaningful negotiations on other issues or legislative initiatives can take place.

Since Japan is our second largest trading partner, and is obviously the most advanced country in Asia, there is an economic interdependence between the U.S. and Japan. The United States must depend heavily on Japan to pick up some of the economic development burdens in Southeast Asia. There may come a day when Japan will take a more active part in the mutual security arrangements in that troubled area of the world, and thus relieve the U.S. of a substantial burden. But this is far from certain.

A real economic partnership can develop between the U.S. and Japan. No longer, however, should the United States forego concrete economic opportunities for vague political goals. We must gain the same access to foreign markets as foreign countries have to ours. As one observer put it: "Unfortunately, liberalization moves have taken place at a very slow pace and have not been significant. I think we have reached the point where the alternatives are clear:

*See tables 8 and 9.

Japan needs to liberalize trade and investment or Japan will increasingly encounter such restrictions in foreign markets as Japan has erected to insulate its own market."

(1) *Can the United States afford to keep its markets open to Japanese goods, when the conditions of trade are so imbalanced?*

The U.S. trade deficit with Japan grew from $388 million in 1965 to $1.240 billion in 1970. During this period U.S. military expenditures in Japan grew from $346 million to $669 million.

(2) *Would it be possible for the United States Government to work closely with its business and banking community in the same kind of partnership that has developed in Japan?*

There would have to be a major change in our antitrust laws and philosophy before such "cooperation" could occur.

(3) *Is investment by American firms in the Japanese market a means of ameliorating the present economic difficulties between the two countries?*

Joint ventures may create "entangling alliances" between U.S. corporations and Japanese corporations. But from the point of view of U.S. labor, this could compound their present difficulties.

(4) *What has been the experience of the American firms who have investments in Japan?*

(5) *Will the apparent dissatisfaction of Japanese citizens with their export-oriented economy rerve to redirect priorities in that nation toward higher living standards, and thereby relieve Japanese pressure on world markets?*

GLOBAL CHANGES IN WORLD AGRICULTURE

During the past 15 years the production of most farm products in industrial countries has increased more rapidly than consumption or use in those countries. This has led to increased "self-sufficiency" even though achieved by often high price supports and rigid import controls.

Orville Freeman, former Secretary of Agriculture, said on December 2, 1969, "The only country in the world that has tried to do anything about overproduction is the United States." Other countries, particularly in the European Common Market have increased their food and feed grain production dramatically as a result of high price supports and have dumped their surplus production on the world's market at depressed prices, while insulating their own market by the variable import levy.

United States agriculture is a growth industry; it is highly competitive in world markets and exports are a large fraction of the total volume of our output.

There seems to be a need for a careful and systematic study of the degree of protection of agriculture in all industrialized countries and the output and trade effects of existing domestic farm programs. This study could very well show that there is a better way of coordinating trade and production policies in agriculture than the present non-system.

As already mentioned, the European agricultural system is highly protectionist. The European farmers have great political power and France has insisted on the adoption of a common agricultural policy

aimed at self-sufficiency as a price for European unification on industrial products. The level of price supports after "integration" is higher than the average level before "integration".

The problem of how to deal with the European agricultural policy is key to U.S. future trade policy. If, as in the past, the United States takes the position that agriculture and industrial negotiations must proceed separately—which really means we don't do very much about agriculture—then one wonders whether an NTB negotiation would be successful.

Given the ecopolitics of agriculture, it is impossible to visualize in the near future a world of unfettered agricultural production and trade. However, it may be possible to find some agreements on levels of support, import policies and production controls. If these could be achieved, U.S. agriculture would stand to benefit since we are still the most efficient producer of agricultural commodities in the world.

On the subject of the "green revolution"—the improved productivity in agriculture in developing countries—there will be less reliance on developed countries for "food aid." Developed countries will have to rely more heavily on commercial and industrial transactions, hopefully in a better international trading world.

Many farm organization spokesmen have a bifurcated view of foreign trade; they tend to be "free traders" for everybody else, but "protectionists" for agriculture. They speak against quotas for textiles, shoes, and oil but ardently support quotas on wheat, meat, and dairy products.

The actual competitive position of U.S. agriculture, though significant, is somewhat distorted by the inclusion of concessional Public Law 480 "sales" as a part of U.S. exports. These "sales" averaged between $1–$1.5 billion during the fifties and sixties and, for the most part, were for nonconvertible foreign currencies. It was originally part of a surplus disposal program but gradually became one of the Department of State's foreign policy instruments. Without Public Law 480, U.S. agricultural trade would be in near balance, with a small surplus for most years. Given the productivity of American agriculture this does not speak well for the world agricultural market structure.

One of the more immediate problems facing agricultural exports is the prospective adoption by Britain and others of the European variable levy system. Britain is a large agricultural importer (over $1 billion a year from the U.S.) and its adoption of the European system is bound to adversely affect U.S. sales to that market.

(1) Is the European common agricultural policy consistent with the GATT Agreement?

The variable levy system of the Common Market is more protective than a quota system, and is more restrictive than the individual country protection was before the formation of the Common Market's agricultural policy. This result was made possible because the United States, during the "Dillon Round", allowed the Europeans to suspend concessions on some of their agricultural products.

(2) Is the Common Market's agricultural policy negotiable?

(3) Precisely what effect would the adoption of the variable levy system by Britain have on U.S. exports?

*See table 5 in the appendix.

(4) What potential is there for exporting agricultural products to Eastern Europe and Communist China? What impediments are there to this trade?

(5) Should food aid be coordinated in a multinational institution rather than be part of the foreign policy instruments of the individual member nations?

NATIONAL TRADE POLICIES AND INTERNATIONAL RULES AND INSTITUTIONS

National trade policies and international rules and institutions should be under continued review to insure that they don't become outmoded.

The committee has published a study outlining how the GATT is outmoded as an instrument for insuring fairness and reciprocity in international trade.[5] Much additional work needs to be done in this area, particularly with respect to domestic unfair trade practice statutes.

Adequacy of U.S. Laws Dealing With Unfair Trade Practices and "Excessive" Import Competition

Any comprehensive review of U.S. trade policies must examine whether U.S. laws are adequate to deal with what may be termed "unfair trade practices." Is there any laxity in their administration, and are they adequate for the needs of the 70's and 80's?

There are considerable number of "unfair trade statutes" which relate to foreign commerce. The Antidumping Act of 1921, the countervailing duty statute (section 303 of the Tariff Act of 1930), sections 337 and 338 of the Tariff Act, section 252 of the Trade Expansion Act of 1962 are the more specific and prominent of these statutes, but there are others. Many of these statutes are more than 40 years old; some were established to meet particular problems which may no longer exist; the penalties in some may be so strong that administrators may feel constrained not to apply them even if the language of the statute is mandatory. Sections 337 and 338, for example, which deal with unfair methods of competition and foreign discrimination, respectively, have been used very sparingly. In fact, section 338 has never been invoked at all. The countervailing duty law was written to offset the subsidy effect of such devices as the European rebate of indirect taxes on exports. Yet, the law has not been applied in this area even though couched in mandatory terms. A case has been pending on this issue for over two years before the Treasury Department, which appears unwilling to make a decision. If the laws are not adequate or too harsh they should be changed, rather than left as "dead letters" on the statute books.

Administration of U.S. Trade Policy

Under Article I, section 8, of the Constitution, the Congress has the exclusive power to "lay and collect duties" . . . and to "regulate commerce with foreign nations." While preserving its plenary power

[5] "Staff Analysis of Certain Issues Raised By The General Agreement on Tariffs and Trade", Committee on Finance, December 19, 1970.

in this field, the Congress has from time to time delegated limited authority to the President to carry out a trade agreements program established by Congress. But, who actually is charged with administering the program?

The Departments of State, Commerce, Agriculture, Interior, and Treasury, the President's Special Trade Representative, the National Security Council, and now the President's International Economic Council all have an interest in, and responsibility for, overlapping aspects of foreign trade policy. Importer and exporter interests are often separately represented and the result may be administrative inconsistency, delay, "buck passing" and at times interagency warfare within the Executive branch. Often, one does not know precisely who is responsible for a trade policy problem. For example, the Congress established the Office of Special Trade Representative in the Trade Expansion Act of 1962 because it wanted an "independent" *negotiator* not so closely associated with the concerns and needs of foreign governments as would be the desk officers in the State Department. However, when it came to "negotiating" on the textile problem, the Secretary of Commerce, a White House aide, and subsequently a roving Ambassador-at-large were consecutively put in charge.

While the Congress itself is not vested with authority to do the actual negotiating for this government, it does have plenary authority to "regulate commerce with foreign nations." The Executive has tended to go to Congress only to implement something which they have already done. This appears to be a shortsighted approach, and there is a need for a much closer working relationship between the two branches of government *before* the policy is established.

Congressional Prerogatives and Executive Agreements

What is the binding power of an Executive agreement never approved by the Congress? The GATT is such an agreement. The Executive branch tends to view GATT as a legal obligation of the United States, while the Congress tends to view it as a mere executive agreement without the force of law. How and to what extent should such an agreement bind any nation in its dealings with foreign governments? Moreover, what about the status of an executive agreement negotiated without advance authority from Congress which tends to affect the administration, if not the whole meaning, of domestic law? The International Antidumping Code is such an agreement; its negotiation compelled the Congress to enact legislation, making it clear that the Executive branch lacked the power to change the meaning of the domestic statutes through executive agreements.[6]

There have been at least three agreements reached in recent years which have incurred the wrath of a number of Senators and Congressmen. The International Antidumping Code was the most obvious case of usurpation of congressional authority since its purpose was to dilute the force of U.S. unfair trade laws. Moreover, it was never even submitted to the Congress for its approval. The Canadian Auto-

[6] The Congress enacted Title II of Public Law 90–634 (approved on October 24, 1968) which provided, in effect, that the Code's provisions may be applied only to the extent that they (1) do not conflict with domestic law and (2) do not limit the discretion of the Tariff Commission in its injury-determination function under the Antidumping Act of 1921.

mobile Agreement and the American Selling Price Agreement were other examples.[7]

The Executive has "committed" the United States to a "generalized tariff preference" scheme aimed at helping underdeveloped countries.[8] Even though the Executive has recognized that tariff preferences require legislation, it is questionable logic to "commit" the United States to a particular plan without prior congressional review and authorization. The Executive has built up the hopes and expectations of many developing nations while the Congress has been left out of the process. What will happen to U.S. relations with these countries if the Congress rejects the tariff preference plan or substantially alters it to the detriment of low wage imports? How can the President "commit" the United States to a program never even studied by the Congress? Why did the U.S. negotiators agree to one system of generalized tariff preferences, while Western Europe and Japan agreed to a potentially far more restrictive tariff-quota preference system.

This kind of problem usually arises because the Executive branch finds itself with the Hobsonian choice of entering into such an executive agreement or being threatened with dire consequences by foreign governments who do not understand, or appreciate the division of power—the checks and balances—in our system of government. On the other hand the Congressional feeling that such "fait accomplis" are without authority and should never have been agreed to by our negotiators creates a major dilemma in the trade policy area.

SUMMARY

The world's economy has undergone rapid structural changes since 1950. The development of economic power blocs, particularly in Europe, the resurgence of Japan as the second most powerful industrial country in the free world, the movement of American corporations abroad, the persistent balance of payments deficits experienced by the United States and the consequent deterioration in its international monetary position—these are all important factors which have affected and will continue to affect U.S. foreign trade position. It would appear that these structural changes in the world economy will continue at an even faster pace in the 1970's and 1980's, and that domestic U.S. industries and labor will be challenged as never before to meet this competition.

Large American industries can generally adjust to this competition by moving abroad if necessary. The main adjustment problem is felt by American labor and those firms who cannot easily move abroad.

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[7] The United States-Canadian automobile agreement was negotiated after the Canadians subsidized exports of Canadian autos and parts to the United States through a duty remission scheme. The agreement, while providing free access to the U.S. market for Canadian autos and parts, does not provide free access to the Canadian market for U.S. autos and parts. There is an absolute embargo on U.S. used car imports into Canada and a 17.5 percent duty imposed on new car imports. The American Selling Price agreement was negotiated in the face of S. Con. Res. 100 which passed the full Senate and specifically warned the negotiators not to enter into such an agreement without advance authority.

[8] In the Message from the President of the United States on "United States Foreign Policy for the 1970's, a New Strategy for Peace", it is stated on page 47, "To help other Western Hemisphere nations to increase their export earnings and thus contribute to balanced development and economic growth, *I have committed the United States* to a program which would help these countries improve their access to the expanding markets of the industrialized world. (Emphasis supplied.)

Labor is not mobile internationally—one of the pre-conditions for the free trade theory of comparative advantage. It is even highly questionable that labor is mobile domestically to the extent necessary to avoid severe adjustment problems.

If competitive import problems were restricted to only one or two industries, which might be classified as "inefficient", this could be thought of as a natural consequence of competition and hope that the labor contingent in these industries could shift to other more efficient industries. But it appears that the competitive problems affect most American industries to one degree or another, including industries which have employed the latest technological advances known in their fields. This presents an altogether different dimension to the problem of adjustment.

The Department of Labor has yet to do the difficult studies and analysis necessary to assess the degree to which imports and exports have affected American jobs on an industry and a regional basis. We do not know enough about the job qualifications of the worker displaced by imports to understand whether alternative employment is available. This should be a major concern *before* a concession is granted. Unfortunately, it rarely is.

Obstacles to U.S. exports appear to have grown since the Kennedy Round. This is in part the result of the fact that the level of tariffs has been reduced to the point where nontariff barriers play a more prominent role in distorting international trade flows. It is also related to certain actions by the Europeans to increase agricultural protectionism through the variable levy system, and to Japan's slowness in opening its market to imports and investment. The need to cope with nontariff barriers, including agriculture and investment barriers, is pressing. However, no one has taken the lead in showing the Congress specifically what can be gained (or lost) through such a negotiation on NTB's. Indeed, we have no idea what is negotiable. Apparently, the Europeans have taken the position that unless the Congress approves the elimination of the American Selling Price system of valuation negotiated during the Kennedy Round, there is no future in an NTB negotiation.

Dealing with the European Economic Community as a bloc of six nations is a difficult problem. The problem of dealing with an enlarged Community with England, the Scandinavian and Mediterranean countries as full or "associated" members will be even greater. The common agricultural policy of the Community and the use of the border tax—export rebate system of the Community present particularly difficult obstacles for U.S. exports. From statements made in the President's foreign policy message it would appear that the State Department puts a much higher priority on "European unity" than on the commercial interests of the United States in Europe.[9]

The U.S. relations with Japan have become somewhat strained because of the heavy volume of the Japanese imports into this country, particularly of textiles and other consumer goods, and the complete

[9] The President's message on "United States Foreign Policy for the 1970's, A New Strategy for Peace" contains the following statement: "Our support for the strengthening and broadening of the European Community has not diminished. We recognize that our interests will necessarily be affected by Europe's evolution, and we may have to make sacrifices in the common interest. *We consider that the possible economic price of a truly unified Europe is outweighed by the gain in the political vitality of the West as a whole.*" [Emphasis supplied.]

lack of reciprocity which U.S. exporters face when trying to do business with the Japanese. The relationship between currency values and trade flows is also an important factor in Japanese competitiveness, as is the close working partnership between the Government, the banking system and Japan's industries. The Japanese yen appears to be completely out of line with the growth and productivity of the Japanese economy and unless a realinement takes place the alternative may be import restrictions by the United States.

In the world's agricultural economy, there has been a terrific growth in productivity here and abroad to the point where the production of agricultural goods in industrial countries exceeds consumption. Production throughout the world is stimulated by price support programs. The United States supports its agricultural community through price supports and certain import restrictions. However, the U.S. is the only country in the world which has effective production controls on agriculture. The European Community market subsidizes its producers to a much greater extent than does the United States and does not control production. This production is dumped on world markets. In addition, the EEC's variable levy system has sharply cut back U.S. exports to that area which are subject to the levy. The competitive position of U.S. agriculture is somewhat less than the trade figures would indicate since between $1 billion and $1.5 billion U.S. farm exports are given under foreign aid programs mainly for local currencies.

There appears to be a real need to update and revise U.S. unfair trade practice statutes. The unfair trade practice statutes were written more than 40 years ago when composition and magnitude of foreign trade was radically different.

There is also the question of relationships between the Executive and the Legislative branches of Government with respect to foreign trade matters. Clearly, there is a need for a more effective working partnership in this regard.

The Executive branch appears to be divided within its own house on many issues. To date it has lacked a unified, single voice on foreign trade. Nor is it clear that its policy is consistent when it comes to favoring protection for some industry while singing the praises of free trade as a general policy. In addition, the tendency of entering into agreements with foreign nations and submitting them to the Congress as *fait accomplis* continues even though the Executive branch has been turned down on at least two of its negotiated agreements. It would appear wise for the policies to be agreed to by Congress before a negotiation commits the U.S. to a particular program.

These appear to be the major issues facing the United States in the formulation of a foreign trade policy adequate to the needs of the seventies. The answers are not simple. But there is a crying need for an overall review of the world economic structure, how it has changed, and what policies and programs the Legislative and Executive branches of this Government should take to meet the new challenges of the seventies.

APPENDIX

TABLE 1.—U.S. BALANCE OF TRADE, BY REGION, 1965–70

U.S. EXPORTS

[In millions of dollars]

	Total [1]	Western Europe	Canada	Japan	Latin America	Other [2]
1965	26,447	8,896	5,460	2,051	4,234	5,603
1966	29,389	9,577	6,766	2,340	4,720	5,986
1967	30,681	9,670	7,302	2,672	4,669	6,368
1968	33,588	10,539	8,141	2,959	5,274	6,675
1969	36,473	11,638	9,179	3,503	5,532	6,621
1970	42,041	14,205	9,057	4,654	6,495	7,630
U.S. IMPORTS						
1965	−21,496	−6,212	−4,818	−2,439	−4,356	−3,573
1966	−25,463	−7,663	−5,965	−2,974	−4,682	−4,039
1967	−26,821	−8,089	−6,854	−3,017	−4,651	−4,048
1968	−32,964	−10,203	−8,592	−4,069	−5,137	−4,911
1969	−35,835	−10,214	−9,994	−4,893	−5,217	−5,517
1970	−39,856	−11,276	−10,702	−5,894	−5,919	−6,065
U.S. TRADE BALANCE						
1965	4,951	2,684	642	−388	−122	2,030
1966	3,926	1,914	801	−634	38	1,947
1967	3,860	1,581	448	−345	18	2,320
1968	624	336	−451	−1,110	137	1,764
1969	638	1,424	−815	−1,390	315	1,104
1970	2,185	2,929	−1,645	−1,240	576	1,565

[1] Also includes transactions with international organizations and unallocated.
[2] Eastern Europe, Oceania, Africa, and other Asia.

Source: Department of Commerce, Survey of Current Business, various issues.

TABLE 2.—BALANCE OF TRADE (c.i.f. adjusted) 1960–70

[In billions of dollars]

	Total exports (1)	Less Government-financed exports (2)	Commercial exports (3)=(1)−(2)	Total imports f.o.b. (4)	Estimated imports c.i.f. [1] (5)	Overall balance (6)=(1)−(4)	Commercial balance (7)=(3)−(5)
1970	42.7	1.9	40.8	40.0	44.0	+2.7	−3.2
1969	37.4	2.2	35.2	36.0	39.6	+1.4	−4.4
1968	33.0	2.9	30.1	32.0	35.2	+1.0	−5.1
1967	39.9	2.8	28.1	26.8	29.5	+4.1	−1.4
1966	29.4	2.7	26.7	25.6	28.2	+3.8	−1.5
1965	26.7	2.6	24.1	21.4	23.5	+5.3	+.6
1964	25.7	2.8	22.9	18.7	20.6	+7.0	+2.3
1963	22.4	2.6	19.8	17.1	18.6	+5.3	+1.2
1962	21.0	2.1	18.9	16.4	18.0	+4.6	+.9
1961	20.2	1.7	18.5	14.5	16.0	+5.7	+2.5
1960	19.6	1.6	18.0	14.7	16.2	+4.9	+1.8

[1] Imports including the cost of insurance and freight.

TABLE 3.—U.S. MILITARY EXPENDITURES ABROAD

[In millions of dollars]

	Total	United Kingdom	European Economic Community	Western Europe	Other Western Europe	Canada	Latin America	Other Western hemisphere	Japan	All other	Australia New Zealand South Africa	Other Asia and Africa
1946	493	21	----------	−6	----------	31	10	----------	----------	432	----------	----------
1947	455	15	----------	149	----------	8	8	----------	----------	258	----------	----------
1948	799	59	----------	237	----------	22	34	----------	----------	436	----------	----------
1949	621	42	----------	260	----------	20	16	----------	----------	266	----------	----------
1950	576	31	----------	133	----------	26	7	----------	----------	373	----------	----------
1951	1,270	67	----------	244	----------	38	34	----------	----------	883	----------	----------
1952	2,054	136	----------	633	----------	158	30	----------	----------	1,092	----------	----------
1953	2,615	232	----------	962	----------	204	53	----------	----------	1,148	----------	----------
1954	2,642	329	----------	1,127	----------	194	45	----------	----------	928	----------	----------
1955	2,901	370	----------	1,317	----------	218	43	----------	----------	937	----------	----------
1956	2,949	430	----------	1,229	----------	259	46	----------	----------	968	----------	----------
1957	3,216	488	----------	1,336	----------	288	56	----------	----------	1,033	----------	----------
1958	3,435	360	----------	1,485	----------	443	63	----------	----------	1,063	----------	----------
1959	3,107	289	----------	1,362	----------	431	48	----------	----------	957	----------	----------
1960	3,087	287	----------	1,366	----------	387	----------	148	412	----------	75	413
1961	2,998	225	----------	1,305	----------	357	----------	157	392	----------	98	463
1962	3,105	197	----------	1,437	----------	326	----------	163	382	----------	103	496
1963	2,961	184	----------	1,333	----------	296	----------	171	368	----------	105	502
1964	2,880	173	----------	1,318	----------	258	----------	177	321	----------	103	525
1965	2,952	154	----------	1,314	----------	177	----------	163	346	----------	57	733
1966	3,764	146	1,138	----------	251	205	----------	159	484	----------	59	1,323
1967	4,378	210	1,119	----------	287	232	----------	182	538	----------	29	1,779
1968	4,535	173	1,087	----------	277	285	----------	187	580	----------	33	1,913
1969	4,850	208	1,172	----------	247	295	----------	176	651	----------	42	2,058
1970	4,837	228	1,287	----------	258	256	----------	169	669	----------	47	1,924

Source: U.S. Department of Commerce, Survey of Current Business, June 1968, June 1970; Balance of Payments Statistical Supplement, revised edition, 1963.

TABLE 4.—MAJOR FREE WORLD TRADERS WITH EASTERN EUROPE

[In millions of dollars]

Country	Exports			Imports		
	1959	1964	1969	1959	1964	1969
Free world total	2,990	5,402	[1] 8,300	3,038	5,270	[1] 8,300
Germany, Federal Republic	571	839	1,681	535	744	1,328
Italy	120	276	667	155	370	706
France	158	235	558	160	259	452
United Kingdom	203	291	554	326	541	797
Yugoslavia	147	308	451	170	378	507
India	92	270	351	66	281	418
UAR (Egypt)	194	216	[2] 354	160	149	[2] 178
Finland	180	220	347	203	314	328
Japan	29	218	342	44	256	575
Austria	129	215	327	129	198	273
Sweden	99	168	271	105	160	276
United States	89	340	249	81	98	195
All other countries	979	1,806	2,148	904	1,522	2,267

[1] Preliminary estimate.
[2] Estimated on the basis of eleven-months data.

TABLE 5.—U.S. AGRICULTURAL TRADE, 1965–70, IN MILLIONS OF DOLLARS

Year	Exports			Imports, total
	Specified Government programs [1]	Commercial	Total	
1965	1,536	4,693	6,229	3,986
1966	1,564	5,315	6,879	4,454
1967	1,269	5,111	6,380	4,453
1968	1,182	5,046	6,228	4,656
1969	1,018	4,918	5,936	4,957
1970 [2]	957	6,217	7,174	5,667

[1] Includes Public Law 480 sales programs, donations through voluntary agencies, barter for strategic materials and mutual security aid.
[2] Preliminary.

TABLE 6.—U.S. AGRICULTURAL TRADE WITH THE EEC, 1965–1970, IN MILLIONS OF DOLLARS

Year	Exports			Imports, total
	Variable levy [1]	Nonvariable levy	Total	
1965	626	850	1,476	270
1966	642	922	1,564	306
1967	529	931	1,460	331
1968	475	892	1,367	362
1969	340	929	1,269	363
1970 [2]	454	1,105	1,559	419

[1] Includes feedgrains, wheat and flour, rice, beef and veal, pork, poultry and eggs, dairy products and edible lard.
[2] Preliminary.

TABLE 7

U.S. Trade With Selected Countries, 1960-70

(Millions of dollars)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
U.S. total											
Exports	20,608	21,036	21,713	23,387	26,650	27,521	30,430	31,622	34,636	38,006	43,226
Agricultural	4,902	5,084	5,101	5,651	6,439	6,306	6,954	6,448	6,300	6,004	7,226
Nonagricultural	15,706	15,952	16,612	17,736	20,211	21,215	23,476	25,174	28,336	32,002	36,000
Imports	15,073	14,761	16,464	17,207	18,749	21,427	25,618	26,889	33,226	36,043	39,963
Agricultural	3,824	3,691	3,868	4,020	4,143	4,080	4,530	4,472	5,054	4,954	5,665
Nonagricultural	11,249	11,070	12,596	13,187	14,606	17,347	21,088	22,417	28,172	31,089	34,298
Balance	+5,535	+6,275	+5,249	+6,180	+7,901	+6,094	+4,812	+4,733	+1,410	+1,963	+3,263
U.S./Canada											
Exports	3,812	3,837	4,052	4,261	4,921	5,657	6,679	7,172	8,072	9,137	9,084
Agricultural	432	491	513	597	615	620	626	556	595	710	810
Nonagricultural	3,380	3,346	3,539	3,664	4,306	5,037	6,053	6,616	7,477	8,427	8,274
Imports	3,173	3,292	3,684	3,851	4,265	4,858	6,152	7,140	9,005	10,384	11,091
Agricultural	168	194	188	174	176	234	240	201	226	244	308
Nonagricultural	3,005	3,098	3,496	3,677	4,089	4,624	5,912	6,939	8,779	10,140	10,783
Balance[1]	+639	+545	+368	+410	+656	+799	+527	+32	-933	-1,247	-2,007
U.S./E.E.C.											
Exports	3,992	4,169	4,576	4,921	5,309	5,256	5,529	5,667	6,127	7,005	8,423
Agricultural	1,102	1,160	1,151	1,173	1,417	1,477	1,559	1,460	1,367	1,269	1,559
Nonagricultural	2,890	3,009	3,425	3,748	3,892	3,779	3,970	4,207	4,760	5,736	6,864
Imports	2,263	2,226	2,450	2,517	2,829	3,322	4,125	4,454	5,885	5,798	6,612
Agricultural	221	227	232	238	258	270	306	330	368	363	424
Nonagricultural	2,042	1,999	2,218	2,279	2,571	3,052	3,819	4,124	5,517	5,435	6,188
Balance	+1,729	+1,943	+2,126	+2,404	+2,480	+1,934	+1,404	+1,213	+242	+1,207	+1,811

U.S./Japan											
Exports	1,452	1,841	1,574	1,846	2,018	2,084	2,370	2,699	2,954	3,490	4,652
Agricultural	485	554	481	651	720	876	943	865	933	934	1,241
Nonagricultural	967	1,287	1,093	1,195	1,298	1,208	1,427	1,834	2,021	2,556	3,411
Imports	1,149	1,055	1,358	1,498	1,768	2,414	2,963	2,999	4,054	4,888	5,875
Agricultural	43	45	47	46	40	37	37	32	37	37	37
Nonagricultural	1,106	1,010	1,311	1,452	1,728	2,377	2,926	2,967	4,017	4,851	5,838
Balance	+303	+786	+216	+348	+250	-330	-593	-300	-1,100	-1,398	-1,223
U.S./Communist Areas											
Exports	194	134	125	167	340	140	198	195	215	249	353
Agricultural	136	90	102	139	300	104	137	109	121	88	141
Nonagricultural	58	44	23	28	40	36	61	86	94	161	212
Imports	84	85	82	85	102	142	182	180	201	198	226
Agricultural	39	40	39	35	38	48	56	63	60	59	62
Nonagricultural	45	45	43	50	64	94	126	117	141	139	164
Balance	+110	+49	+43	+82	+238	-2	+16	+15	+14	+51	+127
U.S./LDC's											
Exports	7,133	7,303	7,591	8,057	8,967	9,015	10,112	9,960	10,821	11,277	12,989
Agricultural	1,638	1,635	1,720	1,930	2,196	2,050	2,296	2,332	2,277	2,000	2,372
Nonagricultural	5,495	5,668	5,871	6,127	6,771	6,965	7,816	7,628	8,544	9,277	10,617
Imports	5,997	5,739	6,071	6,283	6,711	7,173	7,797	7,709	8,886	9,373	10,450
Agricultural	2,872	2,640	2,682	2,770	2,891	2,808	2,975	2,933	3,381	3,231	3,723
Nonagricultural	3,125	3,099	3,389	3,513	3,820	4,365	4,822	4,776	5,505	6,142	6,727
Balance	+1,136	+1,564	+1,520	+1,774	+2,256	+1,842	+2,315	+2,251	+1,935	+1,904	+2,539

General note: Agricultural and nonagricultural reexports are not readily available by country. Since 85 percent of the total is nonagricultural commodities, reexports by country are included above with the values of nonagricultural exports.

Communist areas are Albania, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, U.S.S.R., and Outer Mongolia. LDC's are the countries in Western Hemisphere, except Canada; Asia, except Communist areas; and Africa, except the Republic of South Africa. [1]Following the Automotive Products Trade Act of 1965, the balance on automotive trade alone accounted for the following in millions of dollars in 1965-70: +613, +422, +239, -160, -681, and -1,042; and as measured by transaction values for imports of cars and trucks, instead of customs values, +633, +500, +406, +154, -308, and -694.

Prepared in the International Trade Analysis Division, Bureau of International Commerce, U.S. Department of Commerce, May 1971.

TABLE 8.—DEFENSE EXPENDITURES

	Percent of GNP		Percent of budget	
	1969	1970 [1]	1969	1970 [1]
United States	9.4	8.9	39.9	36.8
Portugal	6.7	6.5	38.2	36.0
Greece	5.9	5.7	21.7	20.1
Turkey	5.5	5.5	22.8	22.1
United Kingdom	5.8	5.5	18.0	17.2
France	5.1	4.7	21.1	20.5
Germany	4.1	3.9	26.0	24.5
Norway	4.0	3.9	16.8	15.3
Netherlands	4.0	3.8	14.1	13.0
Belgium	3.3	3.2	10.2	10.5
Italy	3.1	2.9	10.1	11.3
Canada	3.0	2.9	16.8	15.4
Denmark	3.0	2.9	10.6	8.4
Luxembourg	1.0	1.0	3.5	3.5
Japan	.8	.8	----------	7.2

[1] Estimates prepared by DOD in September 1970.

Note: Fiscal years where calendar year date not available. Defense expenditures are NATO definition, except Japan. GNP is factor cost. "Economic Report of the President, February 1971," shows U.S. defense expenditures as 8.3 percent of GNP and 44.2 percent of Federal Government expenditures (excluding net interest and subsidies) in calendar year 1969.

TABLE 9.—NATO GOVERNMENT DEFENSE EXPENDITURES AS PERCENT OF GNP

	1965	1966	1967	1968	1969	1970 [1]
United States	8.1	9.1	10.2	10.0	9.4	8.9
Portugal	6.7	6.8	8.0	8.2	6.7	6.5
Greece	4.1	4.2	5.1	5.7	5.9	5.7
Turkey	5.8	5.2	5.4	5.5	5.5	5.5
United Kingdom	6.7	6.5	6.5	6.3	5.8	5.5
France	6.1	5.9	5.9	5.6	5.1	4.7
Germany	5.0	4.7	5.0	4.1	4.1	3.9
Norway	4.2	4.0	3.9	4.0	4.0	3.9
Netherlands	4.3	4.1	4.3	4.0	4.0	3.8
Belgium	3.3	3.3	3.3	3.3	3.3	3.2
Italy	3.7	3.8	3.5	3.4	3.1	2.9
Canada	3.7	3.5	3.7	3.3	3.0	2.9
Denmark	3.2	3.1	3.1	3.3	3.0	2.9
Luxembourg	1.5	1.5	1.3	1.1	1.0	1.0

[1] Estimates prepared by DOD in September 1970.

Note: Fiscal years where calendar year data not available. Defense expenditures are NATO definition. GNP is factor cost.

"Economic Report of the President, February 1971," shows U.S. defense expenditures as 8.3 percent of GNP.

TABLE 10.—U.S. BALANCE OF PAYMENTS: BALANCE ON A LIQUIDITY BASIS AND ON AN OFFICIAL RESERVE TRANSACTIONS BASIS, AND CHANGES IN U.S. GOLD STOCK FOR THE PERIOD 1950–70

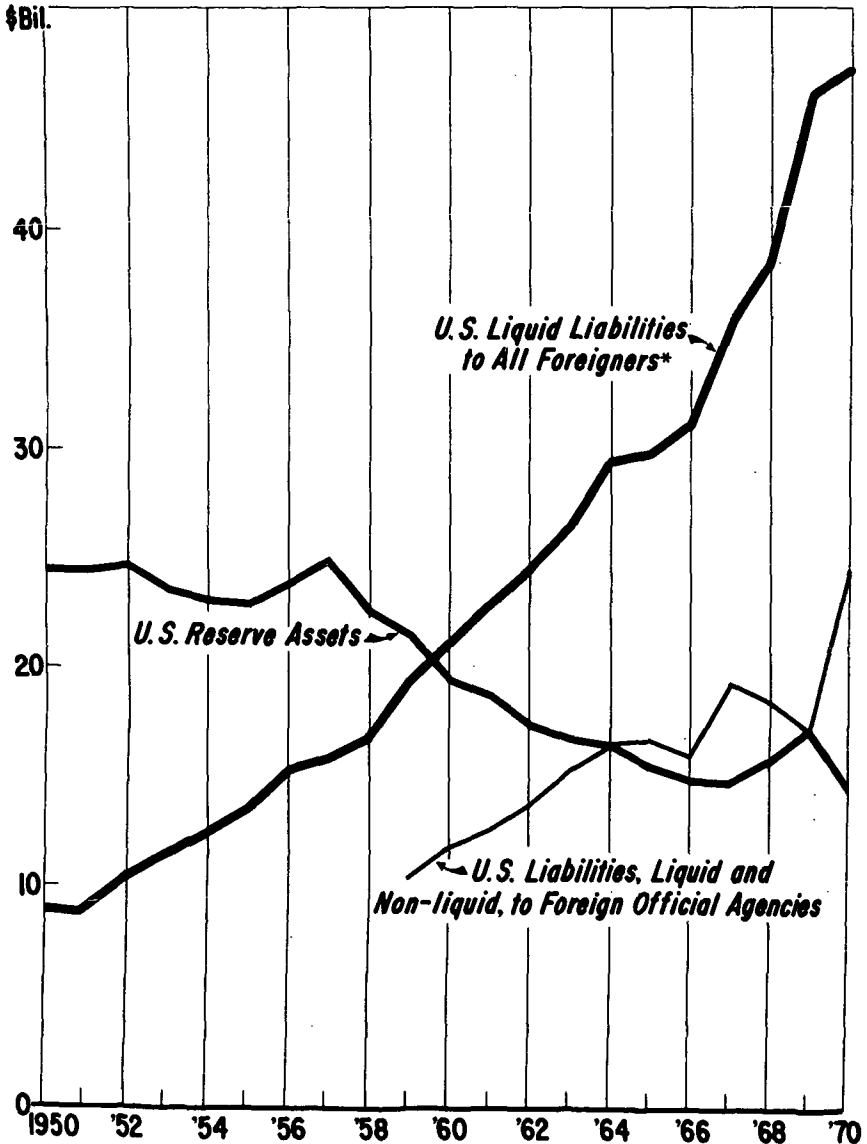
[In millions of dollars]

Year	Balance		Change in gold stock (decrease −)
	Liquidity basis (deficit −)	Official reserve transactions basis	
1950	−3,489	(1)	−1,743
1951	−8	(1)	53
1952	−1,206	(1)	379
1953	−2,184	(1)	−1,161
1954	−1,541	(1)	−298
1955	−1,242	(1)	−41
1956	−973	(1)	306
1957	578	(1)	798
1958	−3,365	(1)	−2,275
1959	−3,870	(2)	−1,075
1960	−3,901	−3,403	−1,703
1961	−2,371	−1,347	−857
1962	−2,204	−2,702	−890
1963	−2,670	−2,011	−461
1964	−2,800	−1,564	−125
1965	−1,335	−1,289	−1,665
1966	−1,357	266	−571
1967	−3,544	−3,418	−1,170
1968	171	1,641	−1,173
1969	−7,012	2,700	967
1970	[2] −3,848	[2] −9,819	−787
Total, 1950 to 1970	−48,171		−13,492

[1] No officially published figures on this basis available for years prior to 1960.
[2] Including $867,000,000 allocation of special drawing rights.

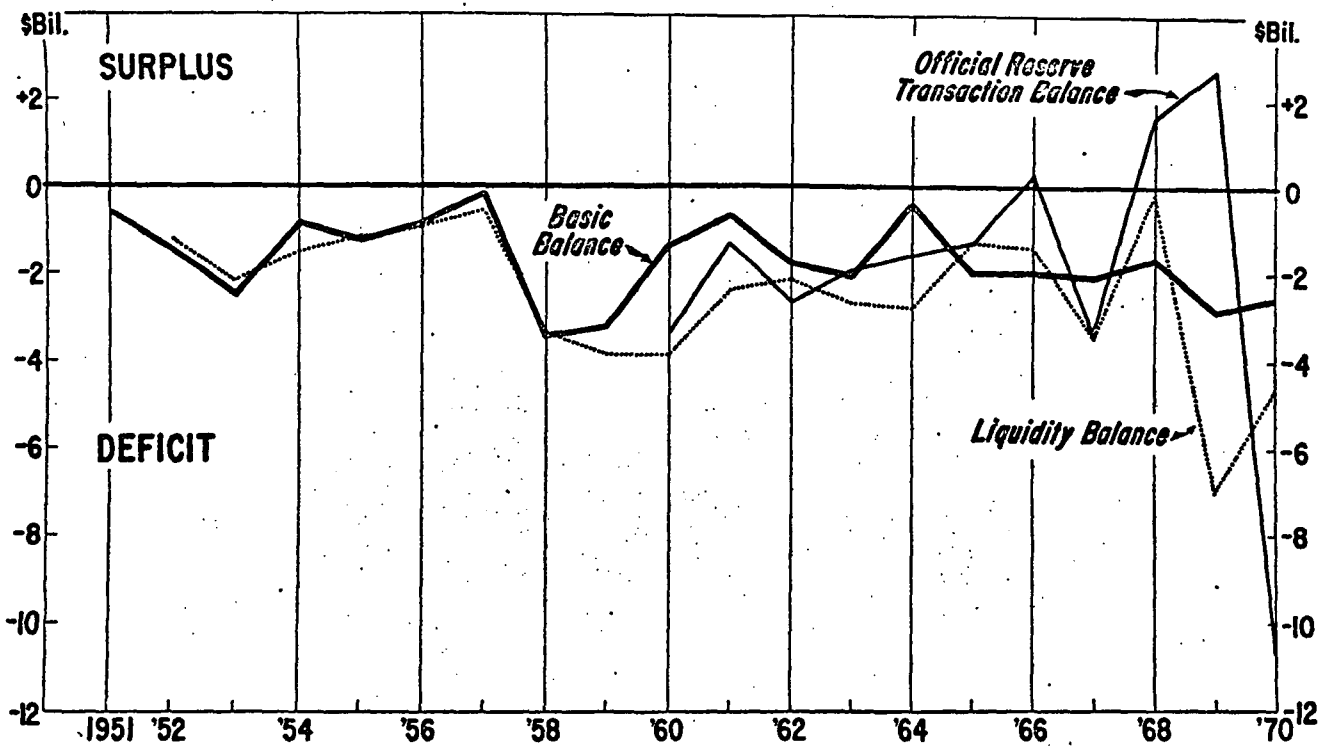
Source: U.S. Treasury Department and the Federal Reserve Bulletin.

U.S. RESERVE ASSETS AND LIQUID LIABILITIES TO FOREIGNERS



*Including non-liquid liabilities to foreign official agencies

U.S. BASIC BALANCE LIQUIDITY BALANCE AND OFFICIAL RESERVE TRANSACTION BALANCE



Appendix C

Staff Analysis of Certain Issues Raised by the General Agreement on Tariffs and Trade (Pamphlet Prepared by the Staff)

91st Congress
2d Session

COMMITTEE PRINT

STAFF ANALYSIS OF CERTAIN ISSUES RAISED BY THE GENERAL AGREEMENT ON TARIFFS AND TRADE

PREPARED BY THE STAFF

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

(NOTE: This document has not been reviewed by the Committee. It is published for the information of the Committee, but does not reflect the approval or disapproval of the Committee or any member thereof.)

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The General Agreement on Tariffs and Trade (GATT)

Introduction

The Committee on Finance directed its staff to prepare a memorandum on certain provisions of the General Agreement on Tariffs and Trade which appear to discriminate against U.S. commerce, or which appear to be inadequate guides for the establishment of fair and reciprocal principles for governing the expansion of world trade. This memorandum is not an exhaustive treatment of all the GATT principles. Rather, it attempts to highlight some of the issues raised by the GATT which the staff feels are important.

GATT and the International Trade Organization

The collapse of international trade in the 1930's and the resulting political and economic effects led some world leaders to conclude that new international economic institutions were essential for international cooperation in international trade and payments matters. The ultimate goals envisaged for such institutions were the prevention of war and the establishment of a just system of economic relations.

During World War II preparations were underway for the establishment of these institutions. The Bretton Woods Conference in 1944 resulted in the emergence of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). But it was recognized that an international organization to regulate trade was a necessary complement to the IMF and the IBRD.[1] During the war years, the U.S. State Department had prepared a draft charter of an International Trade Organization.[2]

At the first session of the United Nations, the Economic and Social Council resolved that a conference to draft a charter for an ITO should be called. Four conferences were held. The last of these conferences was held in Havana from November 21, 1947 to March 24, 1948.

The ITO never came into being. Many of its provisions were considered too extreme. They would have amounted to a virtual delegation of congressional tariff setting and trade regulating powers under the Constitution to the Executive.

To fill the gap caused by the death of the ITO, many of the clauses in the drafts of the ITO charter were taken and put into a document called the General Agreement on Tariffs and Trade (GATT).

[1] The Bretton Woods Conference resolved: "Complete attainment of * * * purposes and objectives [of the IMF] * * * cannot be achieved through the instrumentality of the Fund alone; * * *" and recommended that the government seek agreement "to reduce obstacles to international trade and in other ways promote mutually advantageous international commercial relations * * *."

[2] U.S. State Department Document 2411, December 1945.

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The basic GATT agreement was completed in 1947 but it has never been submitted to the Congress for its study and approval. It is being observed by the United States through a "protocol of provisional application."

The "protocol of provisional application" stated that the eight governments who signed it would undertake "not later than November 15, 1947, to apply provisionally on and after January 1, 1948:

(*a*) Parts I and III of the General Agreement on Tariffs and Trade, and

(*b*) Part II of that Agreement to the fullest extent *not inconsistent* with existing legislation." [3]

This protocol is still in effect, although the GATT has been amended a number of times and affected by other protocols, including some that are not in force themselves. Thus, the basic treaty is a complex set of instruments, applying with different rigor to different countries.[4]

In spite of the fact that the GATT has never been specifically approved by the U.S. Congress as a treaty or otherwise, the executive branch trade spokesmen tend to view GATT as "the law." Whenever the Congress contemplates taking any action to protect a domestic interest, the Executive pointedly reminds it of the "international commitments" of the United States.[5] It is not clear however, that the executive branch demands the same respect for adhering to "international commitments" from other signatories of the Agreement as it demands of itself.

For example, Japan has import quotas on 98 commodities without any finding of serious injury; Britain imposed a "surtax" on imports

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[3] The eight signatures, some with reservations, were Australia, Belgium, Canada, France, Luxembourg, The Netherlands, United Kingdom, and the United States.

[4] For example, the GATT provisions regarding subsidies apply to some countries, but not to others. Even the fundamental principle of GATT—nondiscrimination—has been compromised by numerous exceptions in recent years. The GATT provisions have not prevented the widespread use of nontariff barriers in recent years as substitutes for tariff protection.

[5] The prospect of "retaliation" against U.S. exports if the United States applied "unilateral" restrictions to foreign imports, was discussed by Secretary of State Dean Rusk before the Committee on Finance in these terms:

"Retaliation would simply be what is permitted by the rules of the game as that game is now practiced by some seventy countries accounting for about 85 percent of world trade. I refer, of course, to the General Agreement on Tariffs and Trade—the GATT.

"The GATT is essentially a code of conduct for fairplay in international trade. The United States played a major role in its negotiation in 1947. Like many of the great initiatives of the early post-World War II days, it reflected a conviction that there must surely be a better way to organize man's affairs than had been the case in the preceding decades of self-centered nationalism. In the area of international trade policy, the GATT represents an attempt to prevent a repetition of some of the economic blunders of the 1930's.

"The GATT does this by establishing *a legal framework* for the stability of trade concessions negotiated in good faith among sovereign countries. We accord others access to our market in return for the right of our exporters to sell in their markets. If we impair the access we have agreed to give others, two courses of action are available under the GATT. We ourselves can offer reductions of our import barriers on other products equivalent in trade value to the impaired concession or the foreign country can withdraw concessions affecting an equivalent trade value for American exports in the foreign market. This may sound a bit complicated—*the legal language* of the GATT is much more complicated—but the idea is clear. It is retaliation—by agreement among all parties in advance that restrictive action by one party entitles the aggrieved party, *as a matter of legal right,* to compensatory action." [Emphasis supplied.]

and an "import deposit scheme," in violation of GATT; the Continental Europeans have entered into "special commercial arrangements" on citrus fruits and other products in violation of GATT MFN principles, and its common agricultural policy is significantly more protectionist than the previous individual country restrictions on agricultural imports, another violation of GATT principles. Outside of complaining, the United States has done nothing to demand compensation or to retaliate against these violations of GATT principles.

The GATT was born more than 20 years ago at a time when Europe and Japan were in ruins and the United States completely dominated world trade as well as other matters. In the year in which GATT was negotiated, 1947, the United States had a $10 billion trade surplus. The attitude of many U.S. officials at that time was one of redistributing the wealth. We embarked on an ambitious Marshall plan aid program and later on a technical assistance program. U.S. officials were worried about the so-called "dollar gap" meaning that foreign countries did not have enough dollars to purchase needed imports. It is somewhat understandable that under these circumstances, the GATT would contain certain provisions designed to favor European countries and Japan.

Conditions in 1970 are vastly different from those in 1947. At this point, the GATT should be redrawn to take out the inequitable provisions which effectually discriminate against certain countries, mainly the United States, and to put in new provisions to cope with new conditions in the world economy.

Most-Favored-Nation Treatment

Nondiscrimination is intended to be the cardinal principle of GATT. It is embodied in article I. What you give to one you give to all. This principle is aimed at making anathema discriminatory bilateral trade agreements, preferences, and special commercial relationships.

However, the GATT sanctions the departure from unconditional MFN treatment in the case of customs unions and free trade areas (article XXIV), certain exceptions in article XIV, and the existence of certain preferences in article I, paragraph 2. These "exceptions" effectively allow European countries to depart from MFN treatment when it suits their commercial interests.

The United States generally observes the unconditional MFN principle although in recent years the United States has compromised on its rigid adherence to this GATT principle.[6] This is particularly

[6] For 140 years, until 1923, the United States adhered to a "conditional" most-favored-nation principle, under which we would extend tariff and other trade benefits negotiated with one party to another, only if the latter offered reciprocal benefits. Under "conditional" MFN, no country would get a "free ride." The major considerations in the U.S. decision to change to an "unconditional" MFN principle were:

A. By 1923 international commercial relations were dominated by tariff rates and regulations, whereas previously tariffs were of relatively minor importance as compared with the right to trade at all. Bilateral negotiations with such trading partners were cumbersome and time-consuming.

B. The United States had become a major manufacturing nation and sought immunity from discrimination by other countries in order to compete abroad for markets.

C. Under the Tariff Act of 1922, the President was authorized to impose additional duties on the whole or on any part of the commerce of any country which discriminated against American commerce. Consistency, therefore, required that we not initiate discriminatory rates.

evident in the U.S. request for a GATT waiver on the United States-Canadian automobile pact and the Presidential announcements in favor of a system of special "generalized tariff preferences" for less developed countries.

One of the provisions of article XXIV in defining customs unions was that such formations were required to "facilitate trade between the parties" by eliminating regulations of commerce on "substantially all trade between constituent territories of the union." In fact, however, this was violated in 1952 when the six European nations set up the European Coal and Steel Community to pool resources of coal, steel, iron ore, and scrap in a single market without internal frontier barriers. The GATT considered this project as limited to one sector of the economy and therefore not covered by the provisions relating to customs unions. Nevertheless, in light of the fact that the ECSC would have been agreed to by the six with or without GATT approval, the GATT granted a waiver.

France, West Germany, Italy, Belgium, Luxembourg, and The Netherlands signed in 1958 the Treaty of Rome, establishing the European Economic Community, a common market agreement. The legal question of whether the Rome Treaty is consistent with article XXIV of the GATT has never been settled but is obviously academic. Since the common market of Europe was established in 1958, other important trade blocs have also developed. The outer countries of Europe established the European Free Trade Association in 1959. The countries of South America signed the Montevideo Treaty in 1960, creating the Latin American Free Trade Area (LAFTA), a free trade association among the South American countries. A common market among the Central American countries is in existence and now at Punte del Este agreement has been reached to integrate the Central American Common Market and the Latin American Free Trade Area into a Latin American common market. Japan is currently considering the establishment of a free trade area or common market with Australia and New Zealand (which already have a free trade area between themselves) hoping that it will later include Canada and the United States.

There are also tariff preferences, "reverse preferences" and special commercial arrangements sprouting up all over the world.

In Asia, Australia has unilaterally violated MFN by granting preferences to less developed countries. There is growing sentiment of a Pacific Free Trade Area among Japan, Australia, and New Zealand. The British Commonwealth preference system violates the MFN principle. In short, there are very few countries if any, who observe unconditional MFN treatment, without exceptions.

But, the problem is that the exceptions are growing and threaten to make the MFN principle a mockery. The EEC has special preferences for its 19 former African colonies which in turn give "reverse preferences" to EEC goods. The EEC has concluded or is in the process of negotiating discriminatory commercial arrangements with Greece, Turkey, Israel, Spain, Tunisia, and Morocco. Applications for membership with the community are being considered for Austria, Spain, Ireland, Great Britain, and others. All this involves a massive movement away from MFN.

Tariff preferences are by nature discriminatory, and yet the whole developed world seems to have accepted this as a necessary concession to the demands of the less developed countries. In short, the principle of nondiscrimination is being observed more and more in the breach.

It concerns us to see developing in the world a situation in which more and more trading partners of the United States are being incorporated in regional trade blocs which do not adhere to the unconditional most-favored-nation clause. The United States has eschewed joining a free trade area with North Atlantic countries mainly because of its concern for dividing up the world into competitive regional blocs. But, we have actively supported the participation of other countries in regional trade blocs, which threaten to accomplish the same unwanted result. In addition, as more countries enter into regional trade blocs the U.S. competitive position is bound to suffer from the inherently discriminatory nature of these arrangements. This fact has important ramifications in determining a future U.S. trade policy.

GATT Provisions on Subsidies and Border Taxes

Another important area in which GATT principles are both inadequate and discriminatory concerns subsidies and border tax adjustments.

In essence, the GATT provisions on subsidies and border taxes have been interpreted to permit the rebate of "indirect taxes" (such as value added or turnover taxes) on exports and the imposition of such taxes on imports, but to deny equivalent treatment for "direct taxes," such as income taxes.

TAX SHIFTING ASSUMPTIONS IN GATT

The entire border tax adjustment theory and practice is based on the assumption that "indirect taxes" are always and wholly shifted forward into the final price of a product and that "direct taxes" are always and wholly shifted backward to the factors of production.

The distinction between direct and indirect taxes on the basis of their presumed difference in incidence, though generally accepted two generations ago, is now widely questioned. All taxes on business are increasingly thought of as costs, with varying effects and differential impacts depending on their form, but in one way or another constituting a cost which must be recovered from customers or those who supply resources if the enterprise is to survive. Indirect taxes, at least in the short run, are partially absorbed by the manufacturer depending upon the degree of competition in his markets, and in the markets for his raw materials. Direct taxes, especially the corporate income tax, are shifted forward to the price of the product sold to consumers to the extent that market conditions allow. Well known economists and fiscal experts brought together in a symposium, organized by the Secretary-General of the Organization for Economic Cooperation and Development, in September 1964, reached the following conclusions, (1) "In practice, indirect taxes are not fully shifted into product

prices . . ." and, (2) "Certain direct taxes, and particularly the corporate profits tax, may be partially shifted into product prices: although the degree of shifting may vary from country to country."

Businessmen operate with target rates of return in mind and will pass-on all costs, including taxes, into the price structure of their products to the extent that price elasticity of demand in the market will permit. Thus, modern economic theory suggests that the distinction in the GATT treatment of direct and indirect taxes is an extreme and arbitrary assumption which does not stand the test of economic reality. The Business and Industry Advisory Committee of the OECD (BIAC) in a report on the problem of tax shifting stated: "In a strongly competitive situation the prices obtainable—and hence the degree of tax shifting—are substantially determined by the market itself." In short the GATT on border taxes are not "trade neutral."

Actually, the distinction between "direct" and "indirect" taxes is itself somewhat arbitrary and appears to be based more on prevailing practice than on reason. The distinction is, in fact, not made explicit in the GATT provisions, but flows from interpretations of, and amendments to, various provisions. For example, value added taxes, according to GATT classification are considered to be indirect taxes. However, value added taxes fall on both costs and profits of the producer (value added being defined as the difference between the value of a firm's purchases and sales) and to the extent that they fall on profits how can they be distinguished from a profits tax in effect? Corporate profits taxes are classified by GATT as "direct" falling entirely on the producer. Logically, if corporate taxes were reduced, prices should fall. But to the extent that tax reductions stimulate increased spending and demand, they could stimulate price increases. For example, there is no evidence that corporate tax reductions in 1964, led to price reductions.

HISTORY OF GATT DISTINCTION

The provisions in GATT relevant to border taxes and subsidies, basically articles II, III, and XVI, are drawn from the Havana Charter of the 1940's. These provisions were themselves either a compromise (for example, article XVI) or were adapted from provisions of numerous bilateral trade treaties, including especially the United States-Canada reciprocal trade agreement of the midthirties.[7] The lack of precise or concentrated thinking about the border tax problem is illustrated by the absence of explicit definitions of key concepts.[8]

There is no unified section of the GATT which deals exclusively with border taxes and is quite clear that the provisions of GATT which do cover border tax adjustments were not the product of carefully reasoned theory, or of experience molded in the crucible of extensive usage.

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[7] 49 Stat. 3960 (1936). Effective May 14, 1936.

[8] For example, the meaning of linking the import charge at the border with "charge * * * applied, directly, or indirectly, to like domestic products" is not defined.

When the present GATT language was drawn up more than two decades ago, the question of border taxes did not appear to be a major one. Levels of indirect taxes were much lower. Under these circumstances, overlying simple and sweeping assumptions about tax shifting seemed acceptable, and already existing practices were incorporated in very general terms without searching examination.

IMPORT "EQUALIZATION" CHARGES

Border tax adjustments on the import side, i.e., import equalization charges, are permitted under Article II and III of the GATT, but only for "indirect taxes." Article II (Schedules of Concessions) provides that its terms shall not prevent any contracting party from imposing charges "equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part". This exemption of indirect taxes gives a GATT blessing to the European practice of imposing "equalization" charges at the border. Article III (National Treatment of Internal Taxation and Regulation) provides in paragraph 2 thereof that "products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products." This article is apparently being ignored by European countries which impose discriminatory road taxes against larger American cars. Japan and other countries also discriminate against American cars through their tax system.

EXPORT REBATES

Article XVI, adopted in 1955 deals with the question of border tax adjustments for exports in the following terms:

> The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued shall not be deemed to be as subsidy.

This Article contains many vague terms which need clarification. For example, what is meant by "borne by the like product when destined for domestic consumption" or "remission of such duties or taxes in amounts not in excess of those which have accrued"? These terms seem to be an attempt to apply the "destination principle" to indirect taxes, but the meaning of indirect taxes itself is not at all clear.[9]

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[9] This principle states that internationally traded commodities should be subject to some specified taxes of the importing country and exempt from similar taxes of the exporting country in order to avoid double taxation. The principle contrasts with (a) the origin principle as applied to other forms of taxation on transactions, (b) income taxes levied according to source of income, or domicile or residence of the taxpayer, and (c) property taxes imposed according to the situs of the taxable object.

In 1960, the contracting parties adopted a Working Party Report which listed a number of practices construed to be subsidies.[10] Among these were the remission of direct taxes or social welfare charges on industrial or commercial enterprises and "the exemption in respect of exported goods, of charges or taxes, other than charges in connection with importation or indirect taxes *levied at one or several stages on the same goods* if sold for internal consumption. The implications of practices listed in (b), (c) and (d) of footnote 10 below were not fully appreciated by the United States. They, in effect permitted the European countries to impose border taxes on imports and rebate indirect taxes on exports in accordance with their value added or cascade turnover taxes.

In the late forties and early fifties it is not surprising that U.S. trade officials were willing to incorporate existing commercial practices on border tax adjustments into the GATT agreement. There were much larger problems in international trade than border tax adjustments, which at that time were low—in the range of 2–4 percent and limited to around one-sixth of the goods traded—and then only in the case of a few nations. The United States and a $10 billion trade surplus in 1947 which must have had an effect on our negotiators' attitudes.

But the failure to appreciate the consequences of excluding the so-called "indirect tax" rebates in 1960 from the general prohibition

[10] Point 5 of the report adopted on November 19, 1960, dealing with subsidies stated:

"The following detailed list of measures which are considered as forms of export subsidies by a number of contracting parties was referred to in the proposal submitted by the Government of France, and the question was raised whether it was clear that these measures could not be maintained if the provisions of the first sentence of paragraph 4 of Article XVI were to become fully operative:

"(a) Currency retention schemes or any similar practices which involve a bonus on exports or re-exports;

"(b) The provision by governments of direct subsidies to exporters;

"(c) The remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;

"(d) The exemption, in respect of exported goods, of charges or taxes, other than charges in connexion with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connexion with importation or in both forms;

"(e) In respect of deliveries by governments or governmental agencies of imported raw materials for export business on different terms than for domestic business, the charging of prices below world prices;

"(f) In respect of government export credit guarantees, the charging of premiums at rates which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions;

"(g) The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;

"(h) The government bearing all or part of the costs incurred by exporters in obtaining credit.

"The Working party agreed that this list should not be considered exhaustive or to limit in any way the generality of the provisions of paragraph 4 of Article XVI. It noted that the governments prepared to accept the declaration contained in Annex A agreed that, for the purpose of that declaration, these practices generally are to be considered as subsidies in the sense of Article XVI: 4 or are covered by the Articles of Agreement of the International Monetary Fund. The representatives of governments which were not prepared to accept that declaration were not able to subscribe at this juncture to a precise interpretation of the term 'subsidies,' but had no objection to the above interpretation being accepted by the future parties to that declaration for the purposes of its application."

against export subsidies while including a specific prohibition against rebating "direct taxes", was a major blunder. The United States by that time had run into serious balance of payments difficulties. Western Europe had become a prosperous "third force." Giving away commercial advantages to prosperous Europe for the sake of their own internal tax harmonization objectives was an unwise and costly move, in which vague political objectives out-weighted clear commercial considerations.

Balance-of-Payments Safeguards

Balance-of-payments considerations have exerted and will continue to exert a powerful influence on major countries' dispositions to deal with trade matters. Recent history shows that countries will adopt whatever measures they deem necessary to protect their balance of payments irrespective of GATT. The British imposed an import deposit scheme to control imports and prior to that they and the Canadians adopted import surcharges to protect their balance of payments. The French subsidized their exports even beyond what the inequitable GATT rules allow. In developed as well as the less developed countries quantitative restrictions and licensing arrangements are legion.

The GATT recognizes that member countries may have to protect their balance of payments and international reserve positions and to this end Article XII sanctions the use of quantitative restrictions (quotas). Export subsidies or import surcharges are not allowed under GATT rules as balance-of-payments adjustment mechanisms; import quotas are. This rigidity in the GATT flies in the face of other provisions of the GATT which are more flexible. Limiting available options to quotas also is inconsistent with the main emphasis of GATT to eliminate quotas as a trade protective device.

It is also difficult to understand why, if quotas are sanctioned by GATT as a balance of payments safeguard, the United States would be violating either the letter or the spirit of the agreement if it imposed quotas for balance of payments reasons—a position that has been stated by administration spokesmen. The United States has experienced deficits in its balance of payments in every year since 1950, with two exceptions, and its international reserve position has deteriorated substantially. This would appear to fully justify the application of Article XII quotas for the United States. Member countries in GATT should face up to the lack of flexibility in Article XII, and decide whether quotas should be the only recourse available to a country suffering from chronic balance of payments problems. In facing this issue, the member countries should consider that in recent years many countries have not hesitated to use whatever means they deemed necessary to restore equilibrium notwithstanding the GATT.

Conclusion

In a number of areas the GATT is deficient and discriminatory. Its exceptions to unconditional MFN treatment favor common markets and free trade areas, and threaten to break up the trading world into competitive regional blocs. Recent bilateral commercial arrangements involving the European Common Market and other countries do not even pretend to justify their existence under article XXIV. The United States could gradually become isolated as a trading

nation if it continues to adhere to a policy of encouraging other nations to join regional trade blocs which violate MFN principles, while eschewing U.S. participation in such arrangements under the theory of "multilateralism."

The GATT treatment of subsidies and import charges discriminate against countries relying principally on one form of tax structure—direct or income taxes—in favor of other countries whose revenues are derived from a different system—such as value added taxes.

The GATT safeguard on balance of payments is an anachronism and is inconsistent with other principles in GATT. Furthermore, in recent years major countries such as England and France have imposed import restrictions for balance of payments reasons in complete disdain of GATT principles.

The GATT does not even pretend to be a guide in agricultural trade which is now heavily controlled and subsidized, especially in the European Community.

In short, as presently constituted, the GATT is not a guide to fair trade. Its rules are often inequitable and outdated. It was written at a time when the United States held a virtual monopoly over production and trade and when the rest of the world suffered from an acute shortage of dollars. Trade at that time was mainly between unrelated parties at arms length transactions. Today, trade is increasingly becoming a movement of goods within a multinational business complex. The drafters of GATT may not have forseen all the postwar economic and structural changes. But no one can claim that world conditions have not changed sufficiently to require a new look at the GATT. It is the view of the staff that the GATT should be redrawn to provide for principles of fair and free trade before the Congress approves its provisions.

(Excerpts From the General Agreement on Tariffs and Trade Referred to in the Text of this Print)

ARTICLE I

GENERAL MOST-FAVOURED-NATION TREATMENT

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

2. The provisions of paragraph 1 of this Article shall not require the elimination of any preferences in respect of import duties or charges which do not exceed the levels provided for in paragraph 4 of this Article and which fall within the following descriptions:

(a) preferences in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein;

(b) preferences in force exclusively between two or more territories which on July 1, 1939, were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C, and D subject to the conditions set forth therein;

(c) preferences in force exclusively between the United States of America and the Republic of Cuba;

(d) preferences in force exclusively between neighbouring countries listed in Annexes E and F.

3. The provisions of paragraph 1 shall not apply to preferences between the countries formerly a part of the Ottoman Empire and detached from it on July 24, 1923, provided such preferences are approved under paragraph 5 of Article XXV,[1] which shall be applied in this respect in the light of paragraph 1 of Article XXIX.

4. The margin of preference on any product in respect of which a preference is permitted under paragraph 2 of this Article but is not specifically set forth as a maximum margin of preference in the appropriate Schedule annexed to this Agreement shall not exceed:

(a) in respect of duties or charges on any product described in such Schedule, the difference between the most-favoured-nation and preferential rates provided for therein; if no preferential rate is provided for, the preferential rate shall for the purposes of this

[1] Pending the entry into force of the Protocol Amending Part I and Articles XXIX and XXX, this reference to Article XXV actually reads "sub-paragraph 5(a) of Article XXV," although paragraph 5 is no longer divided into sub-paragraphs (a), (b), etc., as was formerly the case. The present text of paragraph 5 was formerly sub-paragraph 5(a) of Article XXV.

paragraph be taken to be that in force on April 10, 1947, and, if no most-favoured-nation rate is provided for, the margin shall not exceed the difference between the most-favoured-nation and preferential rates existing on April 10, 1947;

(b) in respect of duties or charges on any product not described in the appropriate Schedule, the difference between the most-favoured-nation and preferential rates existing on April 10, 1947.

In the case of the contracting parties named in Annex G, the date of April 10, 1947, referred to in sub-paragraphs (a) and (b) of this paragraph shall be replaced by the respective dates set forth in that Annex.

Article II

SCHEDULES OF CONCESSIONS

1. (a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.

(b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided for therein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.

(c) The products described in Part II of the Schedule relating to any contracting party which are the products of territories entitled under Article I to receive preferential treatment upon importation into the territory to which the Schedule relates shall, on their importation into such territory, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided for in Part II of that Schedule. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date. Nothing in this Article shall prevent any contracting party from maintaining its requirements existing on the date of this Agreement as to the eligibility of goods for entry at preferential rates of duty.

2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product:

(a) a charge equivalent to any internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part;

(b) any anti-dumping or countervailing duty applied consistently with the provisions of Article VI;

(c) fees or other charges commensurate with the cost of services rendered.

3. No contracting party shall alter its method of determining dutiable value or of converting currencies so as to impair the value of any of the concessions provided for in the appropriate Schedule annexed to this Agreement.

4. If any contracting party establishes, maintains or authorizes, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this Agreement, such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule. The provisions of this paragraph shall not limit the use by contracting parties of any form of assistance to domestic producers permitted by other provisions of this Agreement.

5. If any contracting party considers that a product is not receiving from another contracting party the treatment which the first contracting party believes to have been contemplated by a concession provided for in the appropriate Schedule annexed to this Agreement, it shall bring the matter directly to the attention of the other contracting party. If the latter agrees that the treatment contemplated was that claimed by the first contracting party, but declares that such treatment cannot be accorded because a court or other proper authority has ruled to the effect that the product involved cannot be classified under the tariff laws of such contracting party so as to permit the treatment contemplated in this Agreement, the two contracting parties, together with any other contracting parties substantially interested, shall enter promptly into further negotiations with a view to a compensatory adjustment of the matter.

6. (a) The specific duties and charges included in the Schedules relating to contracting parties members of the International Monetary Fund, and margins of preference in specific duties and charges maintained by such contracting parties, are expressed in the appropriate currency at the par value accepted or provisionally recognized by the Fund at the date of this Agreement. Accordingly, in case this par value is reduced consistently with the Articles of Agreement of the International Monetary Fund by more than twenty per centum, such specific duties and charges and margins of preference may be adjusted to take account of such reduction; *Provided* that the Contracting Parties (i.e., the contracting parties acting jointly as provided for in Article XXV) concur that such adjustments will not impair the value of the concessions provided for in the appropriate Schedule or elsewhere in this Agreement, due account being taken of all factors which may influence the need for, or urgency of, such adjustments.

(b) Similar provisions shall apply to any contracting party not a member of the Fund, as from the date on which such contracting party becomes a member of the Fund or enters into a special exchange agreement in pursuance of Article XV.

7. The Schedules annexed to this Agreement are hereby made an integral part of Part I of this Agreement.

Article III

NATIONAL TREATMENT ON INTERNAL TAXATION AND REGULATION

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

3. With respect to any existing tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5. No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.

6. The provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in the territory of any contracting party on July 1, 1939, April 10, 1947, or March 24, 1948, at the option of that contracting party; *Provided* that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be treated as a customs duty for the purpose of negotiation.

7. No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply.

8. (a) The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

9. The contracting parties recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interests of contracting parties supplying imported products. Accordingly, contracting parties applying such measures shall take account of the interests of exporting contracting parties with a view to avoiding to the fullest practicable extent such prejudicial effects.

10. The provisions of this Article shall not prevent any contracting party from establishing or maintaining internal quantitative regulations relating to exposed cinematograph films and meeting the requirements of Article IV.

Article XII

RESTRICTIONS TO SAFEGUARD THE BALANCE OF PAYMENTS

1. Notwithstanding the provisions of paragraph 1 of Article XI, any contracting party, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported, subject to the provisions of the following paragraphs of this Article.

2. (a) Import restrictions instituted, maintained or intensified by a contracting party under this Article shall not exceed those necessary:

(i) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or

(ii) in the case of a contracting party with very low monetary reserves, to achieve a reasonable rate of increase in its reserves.

Due regard shall be paid in either case to any special factors which may be affecting the reserves of such contracting party or its need for reserves, including, where special external credits or other resources are available to it, the need to provide for the appropriate use of such credits or resources.

(b) Contracting parties applying restrictions under sub-paragraph (a) of this paragraph shall progressively relax them as such conditions improve, maintaining them only to the extent that the conditions specified in that sub-paragraph still justify their application. They shall eliminate the restrictions when conditions would no longer justify their institution or maintenance under that sub-paragraph.

3. (a) Contracting parties undertake, in carrying out their domestic policies, to pay due regard to the need for maintaining or restoring equilibrium in their balance of payments on a sound and lasting basis and to the desirability of avoiding an uneconomic employment of

productive resources. They recognize that in order to achieve these ends, it is desirable so far as possible to adopt measures which expand rather than contract international trade.

(b) Contracting parties applying restrictions under this Article may determine the incidence of the restrictions on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential.

(c) Contracting parties applying restrictions under this Article undertake:

(i) to avoid unnecessary damage to the commercial or economic interests of any other contracting party;

(ii) not to apply restrictions so as to prevent unreasonably the importation of any description of goods in minimum commercial quantities the exclusion of which would impair regular channels of trade; and

(iii) not to apply restrictions which would prevent the importation of commercial samples or prevent compliance with patent, trade mark, copyright, or similar procedures.

(d) The contracting parties recognize that, as a result of domestic policies directed towards the achievement and maintenance of full and productive employment or towards the development of economic resources, a contracting party may experience a high level of demand for imports involving a threat to its monetary reserves of the sort referred to in paragraph 2(a) of this Article. Accordingly, a contracting party otherwise complying with the provisions of this Article shall not be required to withdraw or modify restrictions on the ground that a change in those policies would render unnecessary restrictions which it is applying under this Article.

4. (a) Any contracting party applying new restrictions or raising the general level of its existing restrictions by a substantial intensification of the measures applied under this Article shall immediately after instituting or intensifying such restrictions (or, in circumstances in which prior consultation is practicable, before doing so) consult with the Contracting Parties as to the nature of its balance of payments difficulties, alternative corrective measures which may be available, and the possible effect of the restrictions on the economies of other contracting parties.

(b) On a date to be determined by them, the Contracting Parties shall review all restrictions still applied under this Article on that date. Beginning one year after that date, contracting parties applying import restrictions under this Article shall enter into consultations of the type provided for in sub-paragraph (a) of this paragraph with the Contracting Parties annually.

(c) (i) If, in the course of consultations with a contracting party under sub-paragraph (a) or (b) above, the Contracting Parties find that the restrictions are not consistent with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV), they shall indicate the nature of the inconsistency and may advise that the restrictions be suitably modified.

(ii) If, however, as a result of the consultations, the Contracting Parties determine that the restrictions are being applied in a manner involving an inconsistency of a serious nature with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV) and that damage to the trade of any contracting party

is caused or threatened thereby, they shall so inform the contracting party applying the restrictions and shall make appropriate recommendations for securing conformity with such provisions within a specified period of time. If such contracting party does not comply with these recommendations within the specified period, the Contracting Parties may release any contracting party the trade of which is adversely affected by the restrictions from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(d) The Contracting Parties shall invite any contracting party which is applying restrictions under this Article to enter into consultations with them at the request of any contracting party which can establish a *prima facie* case that the restrictions are inconsistent with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV) and that its trade is adversely affected thereby. However, no such invitation shall be issued unless the Contracting Parties have ascertained that direct discussions between the contracting parties concerned have not been successful. If, as a result of the consultations with the Contracting Parties, no agreement is reached and they determine that the restrictions are being applied inconsistently with such provisions, and that damage to the trade of the contracting party initiating the procedure is caused or threatened thereby, they shall recommend the withdrawal or modification of the restrictions. If the restrictions are not withdrawn or modified within such time as the Contracting Parties may prescribe, they may release the contracting party initiating the procedure from such obilgations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(e) In proceeding under this paragraph, the Contracting Parties shall have due regard to any special external factors adversely affecting the export trade of the contracting party applying restrictions.

(f) Determinations under this paragraph shall be rendered expeditiously and, if possible, within sixty days of the initiation of the consultations.

5. If there is a persistent and widespread application of import restrictions under this Article, indicating the existence of a general disequilibrium which is restricting international trade, the Contracting Parties shall initiate discussions to consider whether other measures might be taken, either by those contracting parties the balances of payments of which are under pressure or by those the balances of payments of which are tending to be exceptionally favourable, or by any appropriate intergovernmental organization, to remove the underlying causes of the disequilibrium. On the invitation of the Contracting Parties, contracting parties shall participate in such discussions.

Article XIV [1]

EXCEPTIONS TO THE RULE OF NON-DISCRIMINATION

1. A contracting party which applies restrictions under Article XII or under Section B of Article XVIII may, in the application of such restrictions, deviate from the provisions of Article XIII in a manner having equivalent effect to restrictions on payments and transfers

[1] Text as amended Feb. 15, 1961, on which date Annex J was deleted.

for current international transactions which that contracting party may at that time apply under Article VIII or XIV of the Articles of Agreement of the International Monetary Fund, or under analogous provisions of a special exchange agreement entered into pursuant to paragraph 6 of Article XV.

2. A contracting party which is applying import restrictions under Article XII or under Section B of Article XVIII may, with the consent of the Contracting Parties, temporarily deviate from the provisions of Article XIII in respect of a small part of its external trade where the benefits to the contracting party or contracting parties concerned substantially outweigh any injury which may result to the trade of other contracting parties.

3. The provisions of Article XIII shall not preclude a group of territories having a common quota in the International Monetary Fund from applying against imports from other countries, but not among themselves, restrictions in accordance with the provisions of Article XII or of Section B of Article XVIII on condition that such restrictions are in all other respects consistent with the provisions of Article XIII.

4. A contracting party applying import restrictions under Article XII or under Section B of Article XVIII shall not be precluded by Articles XI to XV or Section B of Article XVIII of this Agreement from applying measures to direct its exports in such a manner as to increase its earnings of currencies which it can use without deviation from the provisions of Article XIII.

5. A contracting party shall not be precluded by Articles XI to XV, inclusive, or by Section B of Article XVIII, of this Agreement from applying quantitative restrictions:

(a) having equivalent effect to exchange restrictions authorized under Section 3(b) of Article VII of the Articles of Agreement of the International Monetary Fund, or

(b) under the preferential arrangements provided for in Annex A of this Agreement, pending the outcome of the negotiations referred to therein.

Article XVI

SUBSIDIES

Section A—Subsidies in General

1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the Contracting Parties in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the Contracting Parties, the possibility of limiting the subsidization.

Section B—Additional Provisions on Export Subsidies

2. The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance to their normal commercial interests, and may hinder the achievement of the objectives of this Agreement.

3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product.

4. Further, as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing, subsidies.

5. The Contracting Parties shall review the operation of the provisions of this Article from time to time with a view to examining its effectiveness, in the light of actual experience, in promoting the objectives of this Agreement and avoiding subsidization seriously prejudicial to the trade or interests of contracting parties.

Article XXIV

TERRITORIAL APPLICATION—FRONTIER TRAFFIC—CUSTOMS UNIONS AND FREE-TRADE AREAS

1. The provisions of this Agreement shall apply to the metropolitan customs territories of the contracting parties and to any other customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application. Each such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party; *Provided* that the provisions of this paragraph shall not be construed to create any rights or obligations as between two or more customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application by a single contracting party.

2. For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate

tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories.

3. The provisions of this Agreement shall not be construed to prevent:

(a) advantages accorded by any contracting party to adjacent countries in order to facilitate frontier traffic;

(b) advantages accorded to the trade with the Free Territory of Trieste by countries contiguous to that territory, provided that such advantages are not in conflict with the Treaties of Peace arising out of the Second World War.

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that:

(a) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;

(b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and

(c) any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of sub-paragraph 5(a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reductions brought about in the corresponding duty of the other constituents of the union.

7. (a) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation

of such a union or area, shall promptly notify the Contracting Parties and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(b) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), the Contracting Parties find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the Contracting Parties shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(c) Any substantial change in the plan or schedule referred to in paragraph 5 (c) shall be communicated to the Contracting Parties, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

9. The preferences referred to in paragraph 2 of Article I shall not be affected by the formation of a customs union or a of free-trade area but may be eliminated or adjusted by means of negotiations with contracting parties affected. This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (a) (i) and paragraph 8 (b).

10. The contracting parties may by a two-thirds majority approve proposals which do not full comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.

11. Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.

12. Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.

Article XXX

AMENDMENTS

1. Except where provision for modification is made elsewhere in this Agreement, amendments to the provisions of Part I of this Agreement or to the provisions of Article XXIX or of this Article shall become effective upon acceptance by all the contracting parties, and other amendments to this Agreement shall become effective, in respect of those contracting parties which accept them, upon acceptance by two-thirds of the contracting parties and thereafter for each other contracting party upon acceptance by it.

2. Any contracting party accepting an amendment to this Agreement shall deposit an instrument of acceptance with the Secretary-General of the United Nations within such period as the Contracting Parties may specify. The Contracting Parties may decide that any amendment made effective under this Article is of such a nature that any contracting party which has not accepted it within a period specified by the Contracting Parties shall be free to withdraw from this Agreement, or to remain a contracting party with the consent of the Contracting Parties.

Appendix D

Responses of the Departmental Witnesses to Senator Abraham Ribicoff's Request for Their Comments on the Testimony of Fred J. Borch (Departments of Commerce, State, and Treasury and Council of Economic Advisers)

THE ASSISTANT SECRETARY OF COMMERCE,
Washington, D.C., June 30, 1971.

ABRAHAM RIBICOFF,
Chairman, Subcommittee on International Trade, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In further response to your letter of May 24, I am pleased to submit comments of the Department on portions of the testimony of Mr. Fred J. Borch, chairman of the board of General Electric Co., before your subcommittee on May 21.

Mr. Borch has raised important questions with respect to divergent domestic and export price trends here and abroad and dual pricing.

For purposes of comparing domestic and export price trends, we believe that country indexes which measure price changes of manufactured products, the principal area of U.S. competition with other industrial nations, are preferable to overall series which include all commodities and even services. We think that wholesale price indexes are more valid in this connection than consumer price indexes, since the latter include and the former exclude services. Also, analysis is facilitated if all series are put on a dollar basis, rather than the mix of dollar and national currencies which Mr. Borch employs. In that way currency revaluations and devaluations are taken into appropriate account.

When wholesale price and export price indexes are limited to manufactures and are adjusted to the dollar basis, as is done in the enclosed table, the data reveal that in the United States, the United Kingdom, and Canada export prices have moved up more rapidly than domestic prices. In France and the Federal Republic of Germany, both sets of prices have advanced at similar rates. In Japan and Italy, there have been slower increases in export prices than in domestic prices. These comparisons, however, are only indicative, since domestic price indexes usually reflect a much broader product composition than do export price indexes; also, in many cases items marketed at home have characteristics different from those marketed abroad. Moreover, countries use a variety of methods in constructing their indexes, further limiting the usefulness of export and domestic price series for country comparisons.

I would like to conclude by supplementing the purely statistical comments made above by a more qualitative judgment. U.S. business leaders, through the National Export Expansion Council and in other ways, have commented on the pricing practices of foreign competitors, with the general observation that marginal pricing in exports seems to be a common practice by foreign competitors. This is not to say that dumping is a general practice, in a legal sense, but that foreign company policies do seem to frequently result in lower pricing than domestic pricing. This may in part be due to national policies that make it possible to price lower for exports—for example, because of tax incentives or tax rebates on exports, tax benefits for capital invest-

ment in production facilities for export, lower interest rates on export credit than for domestic credit, different application of antitrust policies to domestic than to foreign sales, etc.

I hope this information will be useful to your subcommittee.

Sincerely,

ROBERT MCLELLAN,
Assistant Secretary for Domestic, and International Business.

(Enclosure.)

EXPORT AND DOMESTIC WHOLESALE PRICE INDEXES FOR MANUFACTURES IN THE UNITED STATES AND SELECTED INDUSTRIAL COUNTRIES

(1963=100)

	United States		Canada		Japan		France		Germany		Italy		United Kingdom	
	E[1]	D[2]	E[1]	D[2]	E[1]	D[2]	E[1]	D[2]	E[1]	D[2]	E[1]	D[2]	E[1]	D[2]
Year:														
1960	100	101	(3)	106	109	95	99	93	93	90	102	91	95	96
1961	101	100	194	103	105	96	100	96	100	95	98	91	96	98
1962	100	100	100	99	102	96	100	98	101	99	94	95	98	99
1963	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1964	101	101	102	101	99	100	103	102	100	101	102	103	101	102
1965	104	102	104	103	98	104	105	103	102	103	100	106	103	105
1966	107	105	106	106	96	106	108	106	104	106	99	108	110	107
1967	110	106	108	108	99	108	107	105	104	106	99	107	110	108
1968	113	109	114	111	100	112	112	107	108	106	96	107	104	98
1969	118	113	119	116	105	116	113	115	110	111	99	111	107	99
1970	124	117	127	117	111	119	116	111	(3)	123	(3)	119	(3)	107

[1] Export prices for manufactures, on U.S. dollar basis.
[2] Domestic wholesale prices for manufactures, on U.S. dollar basis.
[3] Not available.

Note: Indexes have been adjusted for the floating of the Canadian dollar in May 1962 and May 1970, the French devaluations in January 1960 and August 1969, the German revaluations in March 1961 and October 1969, and the British devaluation in November 1967.

DEPUTY UNDER SECRETARY OF STATE
FOR ECONOMIC AFFAIRS,
Washington, June 24, 1971.

Hon. ABRAHAM A. RIBICOFF,
U.S. Senate.

DEAR SENATOR RIBICOFF: Thank you for your letter of May 24 in which you asked us to comment for the record on the statement of Mr. Fred Borch of General Electric before your Subcommittee on International Trade.

You will find attached a memorandum containing the Department's comments on Mr. Borch's testimony in which we have, as you suggested, concentrated on his discussion of dual pricing trends. In the memorandum, as you will see, we note that the price data presented by Mr. Borch are not the most appropriate ones to use in examining the question of dual pricing. This is so because the consumer price indices used by Mr. Borch contain the prices of services while export price indices are constructed only from commodity prices. A more appropriate comparison is between wholesale and export price indices. Furthermore, the export price indices should be corrected for changes in exchange rate parities over time. Those used in Mr. Borch's testimony do not have this adjustment. We have reconstructed Mr. Borch's exhibits on this basis and note that they do not support the view that dual pricing exists to a significant degree.

With best regards,
Sincerely,

NATHANIEL SAMUELS.

COMMENTS ON TESTIMONY BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE BY MR. FRED J. BORCH, CHAIRMAN OF THE BOARD, GENERAL ELECTRIC CO.

Mr. Borch states that several major trading nations, and in particular Japan, show divergent trends between their export and domestic prices. Mr. Borch offers in support of this statement statistics showing the relationship between export price and consumer price indices for several important trading nations. He concludes that this "dual pricing" has had a serious effect on our competitive position.

There are two major sources of error in Mr. Borch's testimony: the use of consumer price indices for comparison with export price indices and export price indices calculated on a dollar rather than a national currency basis.

Use of consumer price indices as a standard of comparison with export price indices is inappropriate, in our view. Consumer price indices contain the prices of services as well as the prices of tradable products. Over 43 percent of the U.S. consumer price index (CPI), for example, is composed of prices of items such as housing, medical services, transportation, and so forth. Inclusion of the prices of serv-

ices in consumer price indices rules out use of these indices for the purpose of demonstrating "dual pricing." The best indices to use as indicators of the domestic prices of tradable goods are wholesale price indices. Indeed, these are the indices generally used in studies of this nature.

We would note that in addition to being non-comparable to export price indices, consumer indices' behavior is such as to impart a definite bias to a comparison with export prices, or with wholesale prices. In all industrial countries the CPI has risen faster than the wholesale price index. Furthermore, the divergence has been greatest in countries with a rapid increase in productivity. The rapid increase in real wages that result from rapid productivity increases lead to increases in the cost of services, and hence to increases in the CPI. For example, the divergence between the CPI and the wholesale price index is greater in countries—Germany, Italy, and Japan—which have experienced rapid growth in productivity, than in countries—Canada, the U.K., and the U.S.—which have experienced slower productivity growth.

Another source of confusion in Mr. Borch's statistical presentation is the use of export price indices computed in terms of U.S. dollars. Four out of the seven countries shown in the tables attached to the testimony have changed the parity of their currency with the dollar one or more times during the period 1960–1970. This has contributed, particularly in the cases of the U.K. and France, to creating an impression of divergence between domestic and export prices that does not in fact exist to any notable extent; when both indices are denominated in terms of the same currency, they are close together.

The statistics contained in the two exhibits presented by Mr. Borch have been recalculated, using wholesale price indices rather than consumer price indices as the indicator of "domestic" prices and export price indices computed in terms of the national currency of each country. The format of the exhibits has otherwise been preserved. These revised exhibits are attached.

Table III of exhibit B, which shows the same comparison of domestic and export price indices as in Mr. Borch's testimony, but which uses wholesale price indices and corrects for parity changes, reveals a very tight relationship between the two in all cases, with the possible exception of Italy. (Even in the case of Italy, the divergence—8 percent—is very much less than the discrepancies of 16 to 33 percent for Italy, France, the U.K., and Japan shown in Table III of exhibit B to Mr. Borch's testimony.)

It should be noted that these comparisons—and Mr. Borch's—do not really show discrepancies between actual export and domestic prices. They merely show differences between the rates of increase of these prices between 1963 and 1970. Even if larger discrepancies between the indices were revealed than actually exist, these discrepancies would not in themselves be evidence of absolute differences or of "dual pricing".

In any event, there are some theoretical grounds for believing that it is not unnatural for export prices to rise more slowly than domestic prices. Exports include those commodities in which countries have a strong comparative advantage. Furthermore, the market for exports is more nearly a perfect competitive one than any domestic economy

affords. Indeed, so far as the rather rough statistics available permit one to state a case, prices of goods moving in international trade have, overall, risen more slowly in the post-war period than have domestic prices in most economies.

In summary, a comparison of wholesale price indices with export price indices does not support a contention that several foreign nations have been able to maintaian export prices that are markedly lower than their domestic prices. Indeed, the evidence available for analysis is inappropriate to demonstrate any such situation. It would be difficult to use the statistics contained in the testimony under discussion—or even the corrected statistics here presented—as a basis for questioning the adequacy of either the GATT rules on antidumping or the U.S. antidumping law.

(Attachments.)

EXHIBIT A.—EXPORT AND WHOLESALE PRICE INDICES FOR THE UNITED STATES AND MAJOR INDUSTRIAL COUNTRIES

[1963=100]

Year	United States		Canada		Japan		France		Germany		Italy		United Kingdom	
	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic
1960	99	100	95	94	102	99	99	91	100	96	102	99	96	96
1961	101	100	96	95	98	100	98	94	100	98	98	99	96	98
1962	100	100	99	98	98	98	99	96	100	100	98	102	97	99
1963	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1964	101	100	101	100	101	100	104	104	100	101	101	103	104	103
1965	104	102	103	102	101	101	105	104	102	103	102	105	104	107
1966	107	106	107	106	101	103	108	107	103	105	101	107	106	109
1967	110	106	109	108	101	105	107	106	102	104	102	106	106	108
1968	111	108	113	110	102	106	106	105	101	99	101	107	117	112
1969	115	113	116	116	105	108	114	115	102	101	105	111	122	116
1970	112	117	119	117	110	112	125	124	104	107	110	119	128	125

Sources: International Financial Statistics OECD Main Economic Indicators.

Exhibit B

TABLE I.—PERCENT INCREASE IN DOMESTIC (WHOLESALE) PRICE INDEXES

Country	A. 1960–64	B. 1964–70	C. 1960–70
Japan	1	12	13
Italy	6	13	20
United Kingdom	7	21	30
France	14	19	36
Germany	5	6	11
Canada	6	17	24
United States	0	17	17

TABLE II.—PERCENT INCREASE IN EXPORT PRICE INDEXES

Country	A. 1960–64	B. 1964–70	C. 1960–70
Japan	−1	9	8
Italy	−1	9	8
United Kingdom	8	23	33
France	5	20	26
Germany	0	4	4
Canada	6	18	25
United States	2	21	23

TABLE III.—EXCESS OF DOMESTIC PRICE INDEXES OVER EXPORT PRICE INDEXES (EXPRESSED IN PERCENT)

Country	G. 1960	#. 1964	I. 1970
Japan	−3	−1	+2
Italy	−3	+2	+8
United Kingdom	0	−1	−2
France	−8	0	−1
Germany	−4	+1	+3
Canada	−1	−1	−2
United States	+1	−1	−4

COUNCIL OF ECONOMIC ADVISERS,
Washington, June 7, 1971.

Hon. ABRAHAM A. RIBICOFF,
Chairman, Subcommittee on International Trade of the Senate Finance Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In response to your letter requesting my comments on the statement of Mr. Fred Borch before your committee, let me begin with a few comments on the data used by Mr. Borch in his discussion of divergent price trends among major trading nations.

Mr. Borch uses the Consumer Price Index as the domestic basis of comparison. While relative rates of change in the consumer price indexes of different countries can be used as indicators of intercountry differences in the general pace of inflation, they are much less valid as a measure to compare with export prices, since the CPI includes a substantial component of services, of which very few enter directly into international trade. For this reason, the wholesale price index, which excludes services, may be considered a better basis for such comparisons. In addition, many economists feel that, in attempting to measure international competitiveness, it is better to confine the comparisons to the manufacturing sector, since agricultural trade is so heavily influenced by nonprice constraints. Finally, although there is no explicit indication, it appears that Mr. Borch's table utilizes export price indexes based on dollar values, while his wholesale price indexes are in national currency terms. Comparisons made on this basis are affected to an unknown degree by exchange-rate changes. Such changes certainly affect competitive positions (although their impact seems to have been very small during the period under consideration), but they are logically distinct from the problem Mr. Borch is discussing. A clearer picture can be obtained if both series are presented in the same units: either both on a dollar basis or both on a national currency basis.

In view of all these considerations, I attach here a table comparing unit value indexes for manufactured exports with wholesale price indexes in manufacturing, both on a dollar basis, for roughly the same period covered by Mr. Borch. The countries included in the "competitors' index" are those listed by Mr. Borch (other than the United States), plus Belgium, the Netherlands, and Sweden. What these figures show is that, while for the United States the export unit value index increased by about 6 percentage points more than the wholesale price index over the 10-year period, our competitors experienced, on the average, a rise in the export unit value index some 4 percentage points lower than that in the wholesale price index. In other words, the phenomenon that Mr. Borch comments on is still present, but the discrepancy is considerably less than is suggested by his figures, and it appears to be at least as much a matter of our export unit values going up more than our wholesale prices than the opposite phenomenon for the competitors.

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One more statistical point is relevant. Recent work has revealed that, among their other problems, export unit value indexes fail to make proper adjustment for quality improvements. It is estimated that, if such improvements were taken fully into account, the U.S. index would be lowered by some two-thirds of 1 percent per year, or by nearly 7 percent over a 10-year period. There are indications, furthermore, that this bias is slightly greater for the United States than for other industrial countries.

In sum, there appear to be divergent price trends although they are probably less marked than Mr. Borch's comparisons suggest. On the question of what causes this divergence, there is as yet very little solid evidence, and indeed the entire divergence could conceivably be a statistical illusion. As Mr. Borch suggests, it seems likely that most other countries place more importance on the export sector than does the United States—a fact which is not surprising in view of the fact that this sector plays so much smaller a role in our total economy than in those of our major trading partners. Just how this difference in emphasis translates itself into the price behavior we have observed is not yet clear, however.

It may well be that some of the government policies Mr. Borch describes play a role. In particular, the movement toward increasing reliance on indirect taxes on the part of many competitor countries tends to hold down increases in the export price index relative to domestic indexes since the export indexes are calculated net of indirect taxes. There is also evidence, however, which suggests that differences in the behavior of private firms here and in competitor countries also play a role, and perhaps an even more important one.

Some preliminary evidence indicates that, whereas in the United States export profitability has tended to be constant in the face of cyclical changes in demand, in competitor countries this profitability tends to be more responsive to changes in demand conditions, as well as displaying a declining trend. This evidence is consistent with the possibility that foreign exporters are more inclined than their American counterparts to reduce prices when it is necessary to maintain or expand export sales.

Before leaving this subject, it is worth noting that the divergent price trends reversed themselves during 1970, when export prices rose more rapidly than domestic prices in most major competitor countries, while they rose somewhat less rapidly than domestic prices in the United States. Unfortunately, it is too soon to know the reason for this reversal, or to predict how long it may be expected to continue.

Finally, a brief comment concerning the suggestions made by Mr. Borch in the latter half of his testimony. This Administration continues to give strong support to the DISC proposal, which would provide for simpler and more equitable taxation of export earnings, and to the ADR proposal which would provide liberalized depreciation rules for tax purposes. We share his conviction that the enactment of these measures would make an important contribution to the international competitiveness of American firms, and thus to our trade position.

Sincerely,

HENDRIK S. HOUTHAKKER.

UNITED STATES: COMPARATIVE COST-PRICE MOVEMENTS[1] (U.S. DOLLAR BASIS)

[1963=100]

	Export unit values		Wholesale prices	
	U.S. index	Competitors index	U.S. index	Competitors index
1961	100	101	100	99
1962	100	100	100	99
1963	100	100	100	100
1964	101	102	100	102
1965	104	103	102	104
1966	107	104	105	106
1967	110	106	107	107
1968	113	105	110	108
1969	118	109	114	112
1970	124	116	118	120

[1] Data for all countries pertain to manufacturing sectors.
Source: IMF Research Department; wholesale price index converted to U.S. dollar basis by CEA.

EXHIBIT A

EXPORT AND DOMESTIC CONSUMER PRICE INDICES for THE UNITED STATES AND MAJOR INDUSTRIAL COUNTRIES (1963=100)

Year	U. S.		Canada		Japan		France		Germany		Italy		U. K.	
	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom	Exp	Dom
1960	99	96	a	96	102	82	99	89	93	91	102	83	95	91
1961	101	97	104	97	98	87	100	91	98	94	98	84	96	94
1962	100	98	100	98	98	93	99	95	100	97	98	93	97	98
1963	100	100	100	100	100	100	100	100[b]	100	100	100	100	100	100
1964	101	101	101	102	101	104	104	103	100	102	101	106	102	103
1965	104	103	103	104	101	112	105	106	102	106	102	111	104	108
1966	107	106	107	108	101	117	108	109	103	110	101	113	108	112
1967	110	109	109	112	101	122	107	112	102	111	102	118	108	115
1968	111	114	113	117	102	129	106	117	101	113	101	119	101	121
1969	115	120	116	122	105	136	109	124	104	116	105	122	105	127
1970	122	127	123	126	110	146	111	131	114	120	110	128	112	135

Source: International Monetary Fund, International Financial Statistics, various issues.

a Component parts of Canadian export index changed in 1961; on previous index, value for 1960 would be 109.

b Statistical base for the French domestic index changed in 1963 and following years.

EXHIBIT B

Table I
% Increase in Domestic Price Indices

Country	A. 1960-1964	B. 1964-1970	C. 1960-1970
Japan	27%	40%	78%
Italy	28	21	54
U.K.	13	31	48
France	16	27	47
Germany	12	18	32
Canada	6	24	31
U.S.	5	26	32

Table II
% Increase in Export Price Indices

	D. 1960-1964	E. 1964-1970	F. 1960-1970
Japan	-1	9	8
Italy	-1	9	8
U.K.	7	10	18
France	5	7	12
Germany	7	14	23
Canada *	-3	22	18
U.S.	2	21	23

Table III
Excess of Domestic Price Indices over Export Price Indices
(expressed in %)

	G. 1960	H. 1964	I. 1970
Japan	-20	+3	+33
Italy	-19	+5	+16
U.K.	- 4	+1	+21
France	-10	-1	+18
Germany	- 2	+2	+ 5
Canada *	- 7	+1	+ 2
U.S.	- 3	0	+ 4

Because of a statistical change in the Canadian export index in 1961, and following, in the case of Canada the 1961 figure is used instead of 1960.

THE UNDER SECRETARY OF THE TREASURY,
Washington, D.C., July 9, 1971.

Hon. ABRAHAM RIBICOFF,
Chairman, Subcommittee on International Trade,
Committee on Finance, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I am writing in response to your request of May 24 to Secretary Connally for comments on the statement made by Mr. Fred Borch before the Subcommittee on International Trade of the Senate Finance Committee on May 21, 1971, particularly with reference to the dual pricing trends between export and domestic prices among major trading nations.

While there may be some question about methodology in examining these pricing trends, I think we can all agree that we will have to do better in the future than we have in the past. An analytical point is that it may be questionable whether a comparison of export price indices and consumer price indices most accurately reflects the underlying relationship between internal and external prices. It is clear that the questions of export pricing and export performance deserve closer attention. The Administration's proposal for the DISC could improve our performance by offering to domestic firms tax treatment comparable to that offered to exporters abroad. This objective would be achieved by permitting the deferral of corporate income tax, so long as these profits are employed in support of export efforts. DISC would also provide a rule of thumb for inter-company pricing which will remove an element of uncertainty in the producer's assessment of the profitability of export operations and put our inter-company pricing rules more in line with those governiing foreign exporters.

Passage of the pending Eximbank legislation will also be beneficial. The legislation would grant the Bank substantially more flexibility in meeting the needs of U.S. exporters and enable the Bank to provide export financing facilities which are fully competitive with those existing worldwide.

With reference to Mr. Borch's statement that direct and indirect subsidies by our competitors have the effect of artificially lowering export prices, you may be assured that the Treasury Department will continue its rejuvenated efforts to administer its anti-price discrimination statutes in a way which will protect American industry to the maximum afforded by law. In this connection, you will be pleased to know that we have increased our professional staff in this area fourfold so that we may dispose of complaints more expeditiously.

Mr. Borch also underscored the higher priority given to international trade by other countries. As you are aware, Secretary Connally concurred with your report on "Trade Policy for the 70's" that we need both a change in direction and emphasis in pursuing our foreign economic policy objectives. We should also recognize that meeting our domestic objectives can contribute to improving our external position.

The Government is pursuing and I believe making good progress in restoring non-inflationary growth. But the private sector must pull its own weight in pursuing this goal. Business and labor, alike, must realize their mutual responsibility to temper wage and price increases to the realistic facts of the tough, competitive world of the 70's.

One other point emphasized by Mr. Borch was that our competitive effort has been stifled by the non-tariff barriers of other nations. As Secretary Connally said in his statement before your Subcommittee on May 17, these practices may have been understandable twenty years ago, but they are not today. As you know, we are currently working on the elimination of the restrictive practices of all nations. These trade barriers must be abolished if we are to achieve our common goal of fair and balanced trading relationships.

Sincerely yours,

CHARLES E. WALKER.

Mr. Borch's statement on the dual trends between export and domestic prices of major nations is based on data and their interpretation which raise several questions:

Mr. Borch's comparisons are strongly influenced by the choice of price series. Mr. Borch compares index numbers for export prices, or export unit values, with those for consumer expenditures. The composition of these two series is quite different. Consumer expenditures include services, rent and many commodities (e.g., fresh food) which are either completely absent or unimportant in international trade. On the other hand, there are major items traded internationally, such as raw materials and capital equipment, which do not—at least not directly—appear among consumer expenditures. The comparison of these two price series, therefore, cannot be used to determine whether or not "governments help exporting industries at the expense of the domestic consumers" (Borch No. 7) and whether "domestic price levels" were higher than "export price levels" (Borch No. 11).

Furthermore, there is no way of obtaining from these indices whether prices for a given commodity or groups of commodities charged to domestic customers are higher or lower than prices charged to foreign customers (Borch Nos. 8, 9). Consequently, there is no validity in the statement that prices in 1964 were near a statistical equilibrium. (No. 10) Index numbers can only show changes as recognized by Mr. Borch (No. 3) but the year on which the index numbers are based has no particular significance, and any year can be chosen as a base year.

Whether domestic prices are higher than export prices has to be determined on a product-by-product basis. Index numbers for more or less similar commodities or commodity groups can facilitate a comparison of price movements, but not the absolute levels.

The statistical data presented by Mr. Borch, therefore, cannot be used to support his statement. That does not mean, of course, that his statement that U.S. industry "has been outmaneuvered on the international economic front" (Borch No. 13) is incorrect, but other information would have to be provided to support it.

To illustrate the problem involved in supporting Mr. Borch's statement by a comparison of index numbers for export prices (or unit values) with those for domestic prices, the following tabulations have been prepared. In these tabulations wholesale prices rather than consumer prices were used. The comparison of export prices with wholesale prices is, of course, far from perfect, but it is more consistent than the comparison with consumer prices. Furthermore, several years were used as base years in order to avoid the impression that any particular year can be considered to be "normal" or to represent an "equilibrium" (Borch No. 10).

The figures show that from 1969 to 1970 the rise in export prices was higher than in domestic prices for the United States, Canada, Japan, and France, about the same for the United Kingdom and less for Germany and Italy. If the changes from 1968 to 1970 are compared, export prices rose more than domestic prices, in the U.S., Japan and Germany, and less in Canada, France, Italy and the United Kingdom. If the changes from 1967 to 1970 are compared, export prices rose more in the U.S. (but by a relatively small margin), and all other countries surveyed here except Italy. The same applies for the 1966–70 comparison. The 1965–70 comparison shows similar results, except for Japan, where domestic and export rises were about the same. In the 1964–70 comparison both Japan and Italy show a slower rise in export than in domestic prices, and the same applies to the 1963–70 comparison.

To sum up, only in Italy among industrialized countries selected here (and by Mr. Borch) did export prices rise less than domestic prices, consistently, no matter from which of the years 1959 to 1963 the rise to 1970 is calculated. In the case of Japan, one has to go back to 1964 to notice a slower rise in export than in domestic prices. The changes from 1965 were about the same, and since 1966 Japanese export prices appear to have risen more than domestic prices. In the case of France, the export prices appear to have risen slightly less than domestic prices only since 1968, and in the case of Germany only since 1969.

As indicated earlier there are many differences in the composition of the data, in the way they are collected, and the units in which they are measured. Conclusions can only be very tentative, therefore, and when attempts are made to make comparisons they should be based only on relatively large differences in the movements. However, the data do demonstrate that different sets of data can lead to rather different conclusions than those indicated in Mr. Borch's statement.

MOVEMENTS OF DOMESTIC WHOLESALE PRICES AND EXPORT PRICES OR UNIT VALUES OF SELECTED INDUSTRIALIZED COUNTRIES

[1963=100]

	United States		Canada		Japan		France		Germany		Italy		United Kingdom	
	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
1960	99.0	100.0	95.0	94.0	106.6	99.0	99.0	91.0	101.0	96.0	102.0	99.0	96.0	95.0
1961	101.0	100.0	96.0	95.0	102.5	100.0	98.0	94.0	100.0	98.0	98.0	99.0	96.0	97.0
1962	100.0	100.0	99.0	98.0	99.5	98.0	99.0	96.0	100.0	100.0	98.0	102.0	97.0	99.0
1963	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1964	101.0	100.2	101.4	100.3	100.2	100.2	103.9	103.6	102.4	101.1	101.4	103.4	102.0	102.9
1965	104.2	102.2	102.7	102.4	99.2	101.0	104.8	104.4	104.7	103.5	101.8	105.0	105.0	106.8
1966	107.5	105.5	107.0	106.1	99.3	103.4	107.7	107.3	106.9	105.3	100.7	106.6	108.0	109.6
1967	109.6	105.8	109.1	108.0	101.0	105.4	106.9	106.3	106.8	104.4	101.6	106.4	110.0	110.9
1968	110.8	108.4	113.0	110.3	101.3	106.2	106.0	104.6	105.7	103.8	101.1	106.8	118.0	115.3
1969	114.8	112.7	115.8	115.5	104.9	108.5	113.9	115.8	111.2	106.0	104.5	111.0	122.0	119.8
1970	121.4	116.8	118.9	117.2	110.4	112.4	125.3	124.3	116.5	112.0	109.6	119.1	130.0	127.7
1970 in percent of:														
1969	105.7	103.6	102.7	101.5	105.2	103.6	110.0	107.3	104.8	105.7	104.9	107.3	106.6	106.6
1968	109.6	107.7	105.2	106.3	109.0	105.8	118.2	118.8	110.2	107.9	108.4	111.5	110.2	110.8
1967	110.8	110.4	109.0	108.5	109.3	106.6	117.2	116.9	109.1	107.3	107.9	111.9	118.2	115.1
1966	112.9	110.7	111.1	110.5	111.2	108.7	116.3	115.8	109.0	106.4	108.8	111.7	120.4	116.5
1965	116.5	114.3	115.8	114.5	111.3	111.3	119.6	119.1	111.3	108.2	107.7	113.4	123.8	119.6
1964	120.2	116.6	117.3	116.8	110.2	112.2	120.6	120.0	113.8	110.8	108.1	115.2	127.5	124.1

Note:
Col. (4) Wholesale prices.
Col. (5) Average Ministry of Finance and Bank of Japan.
Col. (9) Wholesale prices of export goods.
Col. (10) Wholesale prices, industrial; 1968 ff original index excludes value added tax plus 5 points to adjust for break in series.
Col. (14) Industrial output prices.

The following paragraphs and tables taken from Mr. Borch's statement refer to the problem of "dual" pricing trends:

1. I believe the important factors to which this Committee is addressing itself, the trade distorting practices by which other governments seek to attain their international economic objectives, are a significant cause of our declining trade balance. With tariffs since the Kennedy round a less hindrance to trade, these non-tariff distortions have grown increasingly significant during the 60's, and their exercise has become increasingly sophisticated. Some—such as concessionary financing, indirect or direct subsidies, rebates of indirect taxes, and rapid depreciation—have the effect of artificially reducing export prices.

2. These conditions have been visible to many of us for a number of years, but as a nation we are very late in recognizing them. In the statistics which I will present here, the inference can be fairly drawn that we have been badly outmaneuvered on the trade front.

3. May I therefore call your attention to Exhibit A. Cast in index numbers, Exhibit A shows the change in export price levels and consumer price levels for the U.S. and six major industrial countries over the last decade.

4. To put the situation in a little closer focus than Exhibit A, I've had three tables prepared which more graphically illustrate this situation. If you will now turn to Tables I and II, these compare what happened to domestic price indices and export price indices from each of the seven countries during two distinct periods—namely, in 1960–64, and in 1964 thru 1970.

5. Column B puts the various national inflation rates in perspective for the 64–70 period, the period when the U.S. trade balance slipped so seriously.

6. Columns B and E dramatically illustrate that rises in domestic price levels are not necessarily reflected in commensurate rises in export price levels. The U.S. export price index seems obviously to have been affected by our domestic inflation; but Japan, the United Kingdom, and France (and Italy during '60 thru '70 period) with higher inflation rates managed to hold increases in export price levels to rates one-half or less than ours.

7. How could this be done? In such economics, where diversified exports account for a significant share of the total manufactures, this is possible only when governments help exporting industries at the expenses of the domestic consumers.

8. Now, if you will please turn to Table III, it is designed to show the excess in domestic price levels over export price levels for each of the seven countries over three points in time—that is, 1960, 1964, 1970.

9. Column G indicates that, in 1960, all countries export price levels were relatively higher than the domestic price levels—with the Japanese and Italian levels very appreciably higher.

10. Column II for 1964 shows a near statistical equilibrium, but with domestic price levels generally slightly higher than export price levels.

11. Column I shows the dramatic change that took place between 1964 and 1970 with domestic price levels from 16% to 33% higher than export price levels in Japan, Italy, U.K. and France.

12. With such patterns apparent in the ability of some of this countries' major trading partners to insulate their export pricing from their domestic economies, it appears obvious to me that it is dangerous simplification to generalize that inflation, by itself, is the cause of our own trade balance problem. The answer, I suggest, is more complicated.

13. I am convinced on the basis of all the evidence I have seen, that the answer is that we have been outmaneuvered on the international economic front. I refer to the combination of export rebates, dual pricing, tilted tax structures, indirect export subsidies, and the like, which we face in international competition.

Table called "Exports and Domestic Consumer Price Index (Exhibit A),"

And Tables I, II, and III (Exhibit B).

Appendix E

Trade Policies in the 1970's—Report by Senator Abraham Ribicoff to the Committee on Finance

92d Congress
1st Session

COMMITTEE PRINT

TRADE POLICIES IN THE 1970's

REPORT

By Senator ABRAHAM RIBICOFF

TO THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

RUSSELL B. LONG, *Chairman*

MARCH 4, 1971

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LETTER OF TRANSMITTAL

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C., March 3, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate.

DEAR MR. CHAIRMAN: In January I traveled on behalf of the Committee to London, Brussels and Paris. This was shortly after consideration by the Committee and the Senate of trade legislation contained in the Social Security Amendments of 1970.

In my additional views to the Committee Report on this bill, I pointed out that our country's trade policies will increasingly affect our relations with our European allies. My discussions in Europe reinforced this view.

In Brussels, the headquarters of both NATO and the EEC Council, I exchanged views with our extremely knowledgeable envoy to the European Communities—Ambassador J. Robert Schaetzel. During my stay there, I was also briefed on NATO and military matters by our Ambassador to NATO, Robert Ellsworth. In Brussels, some of the foreign officials I talked to included:

Finn Olav Gundelach, Danish Ambassador to the European Communities.

Emmanuel Sassen, Dutch Permanent Representative to the European Communities.

K. D. Christofas, Minister, British Mission to the European Communities.

Louis G. Rabot, Director General for Agriculture, European Communities.

Theodorus Hijzen, Director General for Foreign Trade, European Communities.

In Paris, I renewed my acquaintanceship with Ambassador Arthur Watson. The Ambassador's background as a former Chairman of IBM is proving invaluable in dealing with the French on economic matters. His address last December to the French Diplomatic Press Association reflected his firm grasp of the outstanding economic problems between ourselves and Europe. The Embassy's Economic Minister, Bob Brand, was extremely helpful and his insights into these problems were particularly useful.

Some of the French officials and public figures I met with included:

Jean-Rene Bernard, Economic Advisor to President Pompidou.

Paul Huvelin, President of PATRONAT.

Luc la Barre de Nanteuil, Director, Multilateral Economic Affairs, Foreign Office.

Bertrand Larrera de Morel, Deputy Director for External Trade, Ministry of Economy and Finance.

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In London, I had the opportunity to meet with some of the people involved in British trade policies at this critical juncture in Britain's relations with Europe. Stanley Cleveland, our Economic Minister there, provided me with an excellent background to the problems raised by these negotiations. Others I met with included:

Anthony Grant, M.P., Joint Parliamentary Under-Secretary of State for Trade, Department of Trade and Industry.

Charles D. Wiggin, Head of American Department, Foreign and Commonwealth Office.

John R. H. Whitehorn, Deputy Director General, Confederation of British Industry.

M. H. Fisher, Deputy Editor, *The Financial Times.*

I have tried in the attached report to summarize my impressions of the key issues in U.S.-EEC relations and to suggest what initiatives and action should be undertaken by all concerned to avert future international trade conflicts.

I wish to thank the Department of State and its able representatives abroad for their invaluable assistance.

Sincerely yours,

ABE RIBICOFF.

VI

TRADE POLICIES IN THE 1970's

Introduction

The Congress came close last year to enacting a foreign trade bill which would have had serious implications for both our domestic economy and our foreign policies.

The restrictions against foreign imports contained in the 1970 trade bill raised the grim possibility of the beginning of a trade war between ourselves and our major trading partners. Strong threats of retaliation against the United States were made by Common Market spokesmen and by a number of other countries. Fundamental relationships between ourselves and our closest allies were at stake—but these consequences seemed to be ignored by our policy-makers.

Against this background, I traveled in January on behalf of the Finance Committee to London, Brussels and Paris to explore the reasons for the deepening chill in our relations, and to determine how a constructive dialogue could be initiated before an even greater crisis was upon us.

The blame for the current impasse should not be placed only on the United States. The European Economic Community (EEC) and Japan, through their aggressive trade expansion policies and disregard for basic American economic interests, share at least an equal measure of guilt. Recently, they have been inclined to retaliate instead of negotiate.

Since its disastrous experiment with strong protectionist measures in the 1930's, the U.S. government has strongly advocated freer trade among nations. The successful conclusion of the Kennedy Round, which lowered tariffs by one-third throughout the world, was the most notable effort. As a former Senate delegate to the Kennedy Round GATT discussion from 1963 to 1967, I was pleased to be able to take part in this unprecedented accomplishment.

But today, the traditional methods and old slogans of international trade and investment are simply not relevant when dealing with the increased economic power of the EEC and Japan. The preeminent trading position of the United States in the world has faded, and we have run into difficult economic times and rising unemployment at home. The issue in 1971 for the United States is no longer trade expansion through free trade, but through fair trade.

Any significant change in economic policy today in one industrial nation inevitably has serious effects on industries as well as governments of other nations. Investment flows, balances of payments and trade balances are shaping national interests. As these trends continue, trade policies become more politically explosive. These questions have a direct bearing on fundamental foreign policy issues.

My discussions in Europe last month reinforced my view that during the last quarter of the Twentieth Century geoeconomics will replace geopolitics as the prime concern of international relations.

But the Administration and the Congress have not faced up to this new reality. We must reorder our priorities in foreign affairs elevating international economic problems to the high level of attention they deserve.

Our nation's and the world's future prosperity will increasingly, depend on whether the nations of the world trading community will be able to establish new workable rules of international trade and investment. The responsibility for beginning this formidable task must be shared by the United States, the EEC, and Japan more equally. The U.S. can no longer be expected to bear this burden alone.

In Europe I urged Common Market officials to issue a statement now of the EEC's future intentions, rather than wait to do anything until after negotiations for British entry are completed. This small, but vital step is the minimum necessary at present to get the major trading nations off dead center in resolving the conflicts between them.

At the same time that the Common Market pledges its future cooperation, the Congress must concentrate its own efforts on providing more effective adjustment assistance relief to industries and workers harmed by imports. Until the time is ripe for major legislation to expand world trade and investment, it will be necessary to withstand pressures for restrictions which may not be in the interest of the nation as a whole.

The time for laying the necessary groundwork for creating new norms of international trade conduct is now—and I hope that the Congress will play a constructive role in this vital task.

The 1970 Trade Bill.

The background to the 1970 trade bill provides a case study of how not to make foreign economic policy. While one can understand why many industries vied for greater relief, it is more difficult to condone the infighting between the Departments and agencies of our own government. With the Treasury Department's main concern our balance of payments, Agriculture's in safeguarding our agricultural exports, Commerce's in promoting more U.S. industrial exports and investment abroad, State's trying to keep trade issues separate from foreign policy or submerged beneath diplomatic considerations, and a host of other agencies looking after their own special interests—our government's policies are often contradictory and conflicting.

The most disturbing aspect, however, was our government's failure to develop a defensible position on foreign trade consistent with the national interest and our overall foreign policy objectives. The Administration's casual use of the legislative process last year to apply pressure in a set of negotiations with a specific country constituted a high degree of irresponsibility. The risk far outweighed any possible gain.

Although the trade bill was introduced in late 1969 as a simple housekeeping measure, by the spring of 1970 the Administration was attempting to use it to wring concessions from the Japanese during negotiations in a so-called "voluntary" quota agreement for Japanese man-made and woolen textiles. What started in early 1970 as a tactical, if somewhat heavy-handed, negotiating ploy, clearly got out of hand. This should have been expected since other American industries have

serious problems too. Besides creating a needless crisis in our relations with Japan, the trade bill provided a vehicle for a batch of uncoordinated trade measures. Like Topsy—the 1970 Trade Bill just grew.

The poor state of our economy and rising unemployment understandably contributed to the growing sentiment for relief from increasing rates of imports. But, the passage of a jerry-built trade bill last year could have had disastrous consequence for world trade—and our own economy. Any decision signaling a shift in our nation's past policies should have come about through a careful weighing of all of the consequences, certainly not as a result of an attempt to settle a domestic political debt.

The apprehension and alarm with which the trade bill was viewed abroad was unanimous. Serious threats of retaliation against the U.S. were made by a number of countries—including our closest trading partners and oldest allies.

Last fall, the Europeans argued that passage of the 1970 trade bill would have had a considerable adverse effect on their economies. Quotas on textiles, they pointed out, would have affected all major countries, and shoe quotas would have affected Italy and Spain substantially. The escape clause changes plus the new trigger for quotas, they claimed, would have affected billions of dollars of Europe's exports. The Council of the European Economic Community declared that "the adoption of protectionist measures by an important industrialized country, could unleash a cumulative process of trade restrictions . . . the Community is ready to take the measures necessary to protect its interests should they be endangered."

A most likely first target of any EEC retaliation would have been our considerable soybean exports to the EEC, which amounted to $640 million last year alone.

In addition to the threat of retaliation against American products, there was also serious talk by senior Common Market officials of new restrictions against our large investments in Europe.

The EEC's preparations for a trade battle, which fortunately never came about, are a clear portent of future conflict between the EEC and the United States. Relations between the United States and the EEC in recent years have been steadily worsening. There is little prospect for improvement since internationally, multilateral discussions on trade and monetary affairs are at a standstill.

The alarm raised abroad by the 1970 trade bill was genuine. But it should not have come as such a great surprise. Increased rates of imported goods plus restrictions on American exports in recent years have caused many Americans to take a closer, more critical look at our traditional trade policies.

Changes in American Attitudes

The present unemployment level of 6% in the U.S. is far heavier than any of the industrialized European countries have known for many years. Japan today is at full employment, and the EEC has stated that a "tolerable" unemployment rate is 0.8% in Germany and 3% in Italy. Our current rate of unemployment means that there are more than 5 million Americans today who cannot find work. They are making their voices heard—and they must be helped.

In 1959, 2.3% of America's shoes were made abroad. In 1969, 14% were. In 1959, we imported $283 million worth of wearing apparel—in 1969 the figure was $1.2 billion. Not surprisingly, the AFL-CIO last year supported the proposed quotas on textiles, apparel and footwear. According to their estimates, some 700,000 U.S. workers lost jobs due to imports between 1966 and 1969. A statement issued by the AFL-CIO while the trade bill was being considered, declared "free trade is no longer free nor trade".

Increasingly, certain American industries find themselves unable to compete with cheaper goods produced abroad by lower-wage labor—and often subsidized by foreign governments. Some larger manufacturers have reacted by establishing subsidiaries abroad to take advantage of lower prevailing wage rates there.

While the "runaway mill" may be one way of meeting foreign competition for industry, it is, of course, no solution as far as labor is concerned. When we speak of labor we are talking about people, their families, their communities, and their futures. Explaining the law of comparative advantage to a worker who has been laid off is not a particularly useful exercise.

The most powerful voices in opposition to changes in our current trade policies come from large U.S. corporations and banks whose multinational character and growing investments abroad dictate a freer trade posture. Already their production abroad represents a sizeable chunk of exports from and imports into the U.S. If it seemed strange for businessmen to be fighting for freer entry of goods into this country, and workers, who are after all consumers too, to seek restrictions on this flow—this is only a reflection of the unprecedented changes taking place in world trade patterns.

The Multinational Corporation

A critical factor in U.S.-European relations in the years ahead, and in relations between the underdeveloped and developed nations, is the rapid increase in the internationalization of production. Already, American firms produce more than twice as much abroad as they export. The French reaction to the "American challenge" posed by a rapid expansion of American multinational corporations has already become an important issue between our two countries. While many American companies are in fact expanding faster than their European rivals, European multinational firms more than hold their own elsewhere in the world. The current rate of capital outflow from Japan, the Common Market countries and the United States represents roughly the same proportion of GNP for all three.

At the same time that American investment is still a vital source of technological knowledge and capital for Europe, European countries are now transferring increasing amounts of long-term investment funds to the United States. In 1969, this flow to the United States amounted to $27.5 billion, while the flow to Europe was $26.7 billion.

The rise of the multinational corporation truly represents the beginning of a new era in international economic relationships. The crucial question here is whether this will be a source of conflict or a stabilizing factor. How do you reconcile the efficient exploitation of technological change with the desire of nations for economic independence? Given the enormous power of some of these corporate giants compared to the resources and skills of the less developed nations, the potential for political upheaval is enormous.

Our government, in conjunction with an enlarged EEC and Japan, must face up to the serious impact on foreign policy of the new phenomenon of the multinational corporation. The need to resolve the critical questions of the relationship between the multinational corporation and the nation in which it operates is just as pressing a problem as the task of eliminating barriers to international trade. The recently concluded oil talks and the continuing nationalization of foreign-owned interests around the globe testify to the urgent need of coming to grips with the awesome implications of the multinational corporation.

A Changing World Trade Picture

One fact of economic life that has not yet been fully digested here is that the European Common Market, not the United States, is the predominant trading power in the world today. The EEC, comprised of West Germany, France, Italy, Belgium, the Netherlands and Luxembourg, has already surpassed the United States in the volume of its foreign trade. With the anticipated additions of Great Britain, Norway, Denmark and Ireland, the EEC is expected to account for 40% of all the world's imports. By 1980, it is predicted that the combined GNP of an enlarged EEC will reach the trillion dollar mark.

Another fundamental change in our relations with Europe is that while their balance of payments position has markedly improved, due to strong inflationary pressures on our own economy, our own position is much weaker than it was a decade ago. Our balance of payments deficit in 1970, on an official settlements basis, reached 10.7 billion dollars.

Europe has come a long way from the devastation and ruin of 1945. Even the most casual visitor must be struck by the rapid pace of new construction, the large number of sleek automobiles caught in traffic jams, and the general affluence that pervades Western Europe today.

This economic renaissance is due both to generous Marshall Plan aid and to the ability of six nations with many differences to work together to forge common internal policies. However, largely as a result of these internal successes, problems have been created for the United States.

In spite of its new commercial position of preeminence, the EEC on the whole has continued to carry out policies of the past. Its institutional energies have been focused on the rationalization and harmonization of industry and agriculture within the six Common Market countries. This has inevitably led to frequent conflicts with our own country and there has been little success in ironing out differences. Only last December, Agriculture Secretary Hardin's meeting with the EEC Commissioner Dahrendorf was described as a "disaster" in the *New York Times*' account of this episode.

Japan's Stunning Economic Success

If our relations across the Atlantic have soured because Europe is now more of an equal, so has Japan's preeminent economic position in Asia presented new challenges to our foreign trade policies. Japan's economic growth has been more than matched by its phenomenal export growth. In 1968 and 1969, Japan increased its exports by 24% and 23% each year.

Much of Japan's export growth has been in the American market or in foreign markets traditionally served by U.S. products. This would be more acceptable if the Japanese themselves did not at present have some 100 separate quotas on imports, together with a truly amazing array of administrative procedures which make trading with Japan a painful exercise in frustration. Also, Japanese penetration of American markets has been stimulated by severe EEC restrictions on Japanese exports.

The need to come to terms with this giant in Asia is obvious. It seems to me that the more we must disengage from a military role in Asia, the more we should concentrate on economic policies to achieve stability and balanced growth in the entire region.

We must look beyond our present problems with Japanese textile imports. Actually they are of a very temporary nature since the Japanese are rapidly losing their competitive position. Imports of textiles into Japan itself are on the rise as the level of Japanese wages approaches that of the Common Market countries.

The following listing of comparative wage rates illustrates this:

	Wages per hour in 1969 [1]
United States	320.2
Japan	79.7
France	81.5
Italy	77.0
United Kingdom	131.9
West Germany	129.8

[1] **Unit: U.S. cent.**

These figures also show the great disparity between foreign wage rates and our own. While American technology can do much to overcome this gap, our government must see to it that American industries are allowed to compete on more equitable terms in international trade.

Nontariff Barriers

If the roles of the players have changed, so has the shape of the game itself. Nontariff barriers (NTBs) are today the major impediments to world trade, not tariffs.

To a noneconomist, nontariff barriers are a bewildering maze of restrictive trade practices whose bounds seem limited only by man's fertile imagination. I am told that some 400 different nontariff barriers have been identified. Broadly speaking, however, they can be lumped under several general categories:

(1) Government participation in trade,
(2) Customs and administrative entry procedures,
(3) Standards which impede trade,
(4) Specific limitations on trade quotas, and
(5) Charges on imports.

These barriers present problems that are likely to grow with the rise in sentiment for more effective consumer protection and environmental control all over the globe. The relative competitive positions of whole industries and entire countries can be drastically changed by differences in internal policies from country to country. While our auto industries' recent proposals to raise bumper heights may, in fact, provide a larger measure of safety, imagine how the imposition of this standard would affect our trade relations with Germany and Japan

and other automobile exporters. On the other hand, safety or anti-pollution requirements put on U.S. industries may well price them out of export markets.

The need is urgent to begin dealing with these new problems before different national safety and environmental standards are set in concrete.

The problem of how to negotiate to reduce NTB's is extremely difficult. One suggestion is to trade them off in clusters. Another is to deal in specific policies cutting across particular barriers by setting international standards and guidelines for national decision-making. The greatest difficulty, however, is just getting such negotiations started.

The EEC's Common Agricultural Policy

In Europe, I had the opportunity to discuss the Common Agricultural Policy of the EEC, a nontariff barrier of crucial importance to U.S.-EEC relations. The CAP provides for extremely high artificial support prices for agricultural commodities in all six EEC nations.

With the completion of the Common Agricultural Policy in 1967, EEC imports from the United States for the items covered by the variable levy have declined by 40% in three years. Because the EEC's export subsidies are financed by import levies, there is no financial constraint on export promotion. The EEC system can truly be described as being mercantilistic in its willfull restriction of imports, stimulation of home production, and promotion of exports.

The variable levy system is far worse in its trade effects than import quotas. It is a total negation of any trade competion. The costs of these policies are being borne by third countries—and particularly the United States. It is only to the EEC and Great Britain that American agricultural exports have stagnated or fallen off significantly.

With the anticipated British entry into the Market, the problems of American agricultural exports there will increase. In an economic sense, increased British self-sufficiency in agriculture makes little sense. If Britain concentrated instead on modernizing her obsolescent industries, everyone would benefit. With British adoption of the CAP as it now stands, the United States would be entitled to heavy compensation for the consequent breach of its access rights. This particular question might prove to be academic since the British public is still solidly against UK entry into the Market. In addition to obtaining the most favorable terms for British entry, Prime Minister Heath has a considerable selling job to do within his own country. However, the expectation is that present differences on details of entry will be worked out, and that Britain will be a member of the Common Market by 1973.

If real progress is to be made in reducing trade barriers between ourselves and the EEC, the Common Market countries must begin to seriously consider the substitution of income support for its agricultural sector, in place of its present price supports.

The EEC's Preferential Arrangements

Another EEC policy potentially harmful to the world trading system is the proliferation of discriminatory trading arrangements negotiated by the EEC. Most of these have concentrated on agriculture or primary products. These agreements are in clear violation of the GATT rules.

The number of countries involved in such preferential arrangements is now twenty-four, with others being negotiated. While the present consequences to U.S. trade are still minor, the EEC is on its way to expanding into a world-wide trade bloc which could conceivably include even some Latin American countries. While temporary arrangements with former colonial territories of EEC countries make some sense, its preferential arrangements with Mediterranean countries are much less defensible. These arrangements, by including reverse preferences to EEC countries, could snowball to a point where the U.S. would find its access to world markets severely restricted, and trade competition with other outsiders intensified.

The EEC–NATO Link

In my discussions in Brussels, Paris and London with foreign officials and business spokesmen, certain general themes emerged. Along with a general feeling of relief that the 1970 trade bill had not been enacted, there was serious apprehension expressed over what future restrictive actions the Congress might take.

While there was genuine concern displayed over the deterioration of the U.S.–EEC relations, current EEC trade policies were vigorously defended in terms of the favorable U.S. trade balance with the Common Market. This slightly more than a billion dollar yearly export surplus for the U.S. over the past decade does not, however, tell the whole story. It is unfair to consider U.S.–EEC economic relations as distinct from U.S.–NATO security arrangements. Our trade surplus amounts to only a small fraction of our country's contributions to European security and the European economy.

The current annual costs of maintaining U.S. forces in the European area, including a proportionate share of the support base in the U.S., is estimated at $7–8 billion. We also spend roughly double the percentage of our GNP on defense expenditures than do our NATO allies. Because of this, our favorable trade balance with the EEC should not be evaluated in isolation, especially by Europeans.

We should not hesitate to point to the considerable burden we still assume which enables Europe to pursue its commercial interests and to prosper free from fear of external threats. Our own government's reluctance to link our trade policies with our other foreign policies in Europe undoubtedly encourages our European allies not to take us seriously in defending our economic interests.

In his State of the World message last year, President Nixon stated:

"Intra-European institutions are in flux. We favor a definition by Western Europe of a distinct identity, for the sake of its own continued vitality and independence of spirit. Our support for the strengthening and broadening of the European Community has not diminished. We recognize that our interests will necessarily be affected by Europe's evolution, and we may have to make sacrifices in the common interest. We consider that the possible economic price of a truly unified Europe is outweighed by the gain in the political vitality of the West as a whole."

This was an open-ended invitation to Europe to continue to ignore the economic interests of the U.S.

When the United States threw its weight behind a more unified Europe, we never expected the EEC always to agree with us. But it was fair to expect the Common Market to play a significant role in

improving world economic relations. President Kennedy in 1962 put it this way:

"We do not regard a strong and united Europe as a rival but a partner . . . capable of playing a greater role in the common defense, of responding more generously to the needs of poorer nations, of joining with the United States and others in lowering trade barriers, resolving problems of commerce and commodities and currency, and developing coordinated policies in all economic and diplomatic areas . . ."

His observations are even more pertinent today with the EEC's growing economic power.

European leaders must become more aware that American political support for a more unified Europe will weaken if Europe's increased economic strength is used to harm American interests. It is almost beside the point to list specific European grievances against the U.S. The essential point is that the U.S. and Europe will come into increasing conflict unless there is much greater sensitivity shown by Europeans for American's economic problems—and more of an appreciation for the pressures these generate on the Congress.

The Need for an EEC Initiative

The most significant portions of my discussions did not dwell on past grievances—fancied or real—but on future opportunities to improve relations between the U.S. and Europe. The following are some of the key questions I raised:

1. If Europe insists she cannot do more on security contributions, can she take a more positive role in terms of trade policy and foreign economic policy generally? As NATO issues become less central, there is certainly more room for European initiatives on other fronts—Brandt's *Ostpolitik* furnishes a most appropriate example.
2. Why can't the EEC, as the major trading entity in the world, begin negotiating on two parallel levels—with the UK on one, and the U.S. and the rest of the world on another?
3. The EEC and the U.S. are on a collision course on several issues. Yet, the EEC maintains that the U.S. must wait until enlargement is completed before any broader discussions can be held on third country problems. The U.S. is now in relatively poor economic shape, with a climate of protectionism in the Congress. Under the circumstances, shouldn't the EEC take the lead in stimulating a serious dialogue on our outstanding problems?

The essential problem to my mind, is not one of seeking further reductions of tariffs or eliminating specific quotas, but in ending mutual recrimination and working out ways to coexist and cooperate. From an American point of view, the EEC appears to be looking after its own internal interests to an excessive degree and to the detriment of outside countries. It is difficult to fully accept the argument that the EEC cannot take part in trade negotiations at the same time their enlargement process is taking place.

The problem is surely not one of sufficient negotiating manpower, since the Europeans seem to have an abundance of qualified, competent trade negotiators. The other major argument—that the political unity of the EEC has not progressed sufficiently—can be used in-

definitely. What is obviously lacking is the requisite will to assume responsibility for the world economy as a whole. The U.S., it should be recalled, has been the originator of every major trade initiative on an international basis since 1934.

The most direct European initiative would be for a member country, or the EEC Commission itself to suggest a new trade overture which would be transmitted to other countries after approval by the Council of Ministers. But this approach is not really feasible because of the considerable time this could take. Also, it would be difficult to overcome the great inhibition against undertaking any major action during British entry negotiations.

Recourse to traditional GATT-type negotiations are no longer a solution either. The techniques that worked well to reduce tariffs are grossly inadequate in dealing with NTB's. The EEC is simply too big and powerful to negotiate with other countries in the same way as in the past. In any event, it might take several years before the proper climate in the various countries could lead to formal comprehensive negotiations. The success of the Kennedy Round in reducing tariffs could not be expected to repeat itself without the solution of many other trade and investment problems first.

EEC Statement of Intent

There is, however, one important initiative that should be undertaken now by the EEC with a minimum of preparation and difficulty which could lead toward serious negotiations later.

I believe that the EEC should state now its intention that after enlargement is agreed to in principle, it would actively pursue liberal trade policies and seek a reduction of NTB's. A positive statement of intent now would be a definite plus for the EEC by helping ease pressures for new restrictions in the U.S. This would undoubtedly contribute to more balanced policies here pending the outcome of British entry negotiations.

My suggestion for the issuance of this statement of intent by the EEC was received with sufficient interest in Europe to lead me to believe that this is a distinct possibility. While this declaration is no substitute for eventual high level consultations and negotiations on a host of vexing international economic problems, a statement of intent now could ease the crisis atmosphere between ourselves and Europe over trade issues. If, in addition, Japan could pledge her future cooperation and pledge her restraint, we would have the time necessary for laying the groundwork for serious negotiations in the future.

The longer the EEC waits to make this small start, the more the problems will multiply and positions harden. The time has come to stop discussing petty differences and to begin dealing with the basic philosophical issues involved.

Possible U.S. Initiatives

There are some initiatives that could be undertaken soon with a minimum of difficulty. The Organization for Economic Cooperation and Development, comprised of twenty-two full member states has already scheduled its annual ministerial-level conference this coming June in Paris. Our Secretary of State will chair the meeting this year. This would be an appropriate occasion for the United States to seek OECD Ministerial endorsement of efforts by international institutions to lay

the basis for the creation of a new set of trade and economic policy mechanisms. It would be useful if the Congress could send observers to this conference.

The United States should also seek discussions among Trade and Finance Ministers on the specific policies of member countries which have been causing friction, and try, at a minimum, to sort these non-tariff barriers out.

Another initiative the United States should undertake is to propose the creation of a group of distinguished "wisemen" representing the major trading countries. This format gives the participants more independence from national policies and greater leeway in their discussions. Their deliberations on the outstanding problems of international trade could be the prelude to more formal negotiations. This informal mechanism has been used successfully in the past by the OECD. It should be given serious consideration now as a means of focusing the attention of the international community on these issues.

The New Council on International Economic Policy

Increasingly, commercial and economic issues are replacing traditional security and strategic questions as the mainsprings of foreign policy. If the U.S. is to meet the new challenges to world stability and to its domestic economy, we must formulate our foreign economic policies at the same high level of government as our national security policies.

Geoeconomics is rapidly replacing geopolitics as the prime mover in the affairs of nations today. But the United States, more so than any other industrialized nation, is unprepared to deal with these changed circumstances.

American diplomacy in the 1960's toward Europe, for example, concentrated on NATO political-military issues—but these issues were of declining interest to Europeans. While we concerned ourselves with the NATO order of battle, the Germans were more concerned over orders for Volkswagens.

The recent establishment of the Council on International Economic Policy in the White House reflects a belated awareness of the dangers of treating foreign economic issues on a significantly lower level than foreign political issues. It was also spurred by the realization that some sixty separate bodies in the Executive Branch shared responsibility for foreign economic affairs. The new Council is chaired by the President, with the Secretary of State as vice chairman.

The Council was formally charged with the responsibility for the development of international economic policy and its relations to domestic economic policy. At first blush, the Council appeared to be on a par with the powerful and prestigious National Security Council. But a closer examination of some of the organizational details in the President's announcement reveals some basic weaknesses.

First, where the Council's responsibility overlaps with that of the NSC, in foreign aid, for example, the Council must operate under NSC guidance.

Secondly, in the all-important areas of coordination within the government, and the implementation of decisions reached, the Operations Group given this responsibility is to be headed by the State Department—and not the new Assistant to the President for Foreign Economic Affairs. This divorce of planning and implementation could seri-

ously affect the Council's effectiveness in giving due regard to the domestic and foreign economic consequences of a foreign policy problem.

Creation of the Council was an explicit admission that we have been remiss in properly coordinating our foreign economic policies with our domestic policies as well as our foreign policies. To create such a Council with one hand, and give back to the State Department all of the relevant powers with the other, is to miss what the critical need was.

Thinking Ahead

Better coordination and higher level attention must be accompanied by more long range projections of foreign economic trends. For example, the EEC is now actively considering the creation of a single monetary system. The considerable effects of this new union on our own country should be evaluated now.

Other moves toward greater European economic integration will undoubtedly have great political impact. But I doubt very much whether any planning is underway to protect United States' interests as unity progresses.

More attention should be given to what trade patterns will look like ten and twenty years from now. According to one recent private analysis, as our economy becomes increasingly service-oriented with a relative decline in goods producing industries, exports of manufactured goods should become less important for American producers. According to this theory, U.S. businesses that are labor intensive are more likely to resort to direct production abroad. As returns from overseas rather than exports become more important for our balance of payments, this will also have a great impact on our economy and employment picture. Studies of these and other long range questions must be started now—and their implications weighed not only by the Executive, but by the Congress.

The Role of the Congress

In the short-run, the main task of the Congress should be to provide adequate relief to American industries and to unemployed workers injured by imports. Whether this can be achieved without opening a Pandora's box of indiscriminate protectionist measures depends on the restraint and patience of legislators under heavy pressures. The Congressional Quarterly recently reported that the trade bill was the most heavily lobbied piece of legislation in the past session.

But if the Congress must refrain from taking an activist role in trade policy until serious international negotiations can begin, more relief must be provided by modifying existing mechanisms. There are various possibilities which might offer the help without the negative consequences of major new legislative restrictions.

There could be greater use of countervailing duties under the 1930 Tariff Act to protect American industries from subsidized imports. The justification for applying this law more vigorously is basically that American businesses should not have to compete against the Ministry of Finance of a foreign country. Until some future system of multilateral rules does away with government subsidies entirely, the Secretary of the Treasury should be given the discretion to ease off on these duties once they are set, thereby giving him greater negotiating

leverage. If other countries dislike this approach, they should express willingness to negotiate common international rules on subsidies and countervailing duties on all trade.

Under Article 23 of the GATT, retaliation is permitted against quotas imposed on our own goods. Until now, we have not made recourse to this provision. But if our exports are faced with unreasonable restrictions, we might wish to reconsider in order to defend our economic interests.

Section 252 of the 1962 Trade Expansion Act permits us to raise duties and to impose quotas on foreign agricultural products in order to counter illegal restrictions used against us. This, too, might be used more vigorously, or, at least as a threat.

A recent promising developemnt is the greater willingness displayed by the Tariff Commission to authorize trade adjustment assistance. Assistance to workers under the Trade Expansion Act of 1962 provides for cash readjustment allowances, testing, training, job placement, and relocation if desired.

At present, the maximum cash allowance equals 65% of the national average weekly wage in manufacturing. This should be increased substantially, and such assistance should be made easier to apply for. At the same time that industries are being helped, consideration should be given to requiring industry to report on the steps they are taking to become more competitive or to move into new lines.

An industry harmed by foreign competition should be given a combination of protection and adjustment assistance with the goal being adequate transitional adjustments, rather than providing a permanent crutch.

Present escape clause provisions are too rigid and take too long before a determination of injury is made. The President should have the powers to give immediate relief pending an ultimate determination as to whether relief is called for. This would be particularly beneficial to small businesses dealing in seasonal products which do not have the financial staying power to wait out a final determination of injury. These relatively minor adjustments in present laws would provide more prompt and effective relief from imports that are acknowledged to be either unfair or genuinely injurious to domestic industries and workers.

Because of the far-reaching impact of any new trade legislation, I hope that the Finance Committee this year will hold full and comprehensive hearings, with a greater emphasis on the foreign policy ramifications of proposed actions.

The Global Implications of our Trade Policies

More concerted efforts must be made to put our relations with the Atlantic nations, Japan and the rest of the world on a course relevant to the real issues of the 70's and 80's. Such a course requires the development of new and improved international institutions and consultative frameworks to eliminate nontariff barriers to trade, to regulate policies toward multinational companies, and to harmonize balance of payments problems.

A general principle which must be followed in establishing these new procedures is that when the costs of domestic policies are passed on

to other countries, adequate compensation must be made. This concept should be the guide in dealing with the whole range of trade problems and notably, nontariff barriers.

These are the issues which will concern Europe in the next two or three decades as she unifies further along economic lines. Japan will undoubtedly continue to be preoccupied with trade as she strives to maintain her fantastic growth rate. The Soviet Union faced with rising expectations internally will undoubtedly have to move much further into the mainstream of world trade. Mainland China, as she emerges from her political and economic isolation, will pay more attention to her international trade position.

The extent to which the gap between the have and the have-not nations will be narrowed will depend in large measure on the trade rules devised to assist them in finding markets for their exports. The economic and political stability of the entire world may well depend on how quickly and adequately the desperate needs of these developing nations can be met.

Because of present economic conditions in the United States, and a rapidly changing world economic picture, the EEC and Japan must assume a greater share of the responsibility for the freer flow of trade and investments between nations. We must all work together to halt the slide toward increasing trade conflicts that could destroy the prosperity of all nations. An EEC statement of its future intentions could provide the stimulus needed for the creation of new norms of conduct in international trade.

The development of workable fair rules among competing nations is one of the most pressing tasks we face. The U.S. Senate, and in particular the Finance Committee, have a vital role to play in preparing the way for a new era of international trade and investment. We will be judged by the widsom we show not only in how well we protect the interests of the American worker and our industries, but what regard we give to the future economic well-being of our nation and the entire world.

If my trip to Europe convinced me of anything, it is that the road to the future prosperity of the entire world, including the U.S., is through new efforts at international cooperation between all the major trading countries rather than through seeking temporary national advantage. The leaders of these nations all share the responsibility for establishing an international trading system that will assure the raising of the standard of living of peoples everywhere.

Appendix F

Discriminatory Ocean Freight Rates—Submission for the Record by the Federal Maritime Commission

62-790 O—71—pt. 2——27

Office of the Chairman

Federal Maritime Commission
Washington, D.C. 20573

June 1, 1971

Honorable Abraham A. Ribicoff
United States Senate
Washington, D. C. 20510

Dear Senator Ribicoff:

In February, I had the opportunity to fully apprise Senator Russell B. Long, Chairman, Committee on Finance, of the activities of the Federal Maritime Commission in combating discriminatory ocean freight rates in the foreign commerce of the United States. Enclosure No. 1 is a copy of that report. Your inquiry now affords me the opportunity to supplement that report by advising you of our efforts since that time.

Below is a brief report on our additional activities in this area:

United States/Japanese Trade

In April, I visited government and shipping officials in Japan to discuss shipping problems prevalent in our trade with that country. These problems include freight rate disparities. I have directed the Commission's staff to work on a joint U.S.-Japan working group to seek solutions to the overall disparity problem. However, the work of the staff which began over a year ago is continuing, concentrating on those individual commodities which are subjected to seriously disparate freight rates. I am informed by the staff that a recommendation for formal Commission action against the carriers serving the U.S. Atlantic Coast ports is presently being prepared. Over thirty commodities moving in this trade will be included under that recommendation.

The Pacific Westbound Conference, representing the conference carriers in the trade with Japan serving the U.S. Pacific Coast ports, has just advised the staff that it has completed its analysis of the list of disparately rated commodities submitted to them by the staff for justification or equalization. The Conference has

offered to meet with the staff to discuss this problem and that offer is being accepted for a date shortly after the first session of the FMC-Ministry of Transport "working group" to meet in June.

Enclosure No. 2 is an unclassified Department of State Airgram, which discusses the U.S.-Japan disparity problem from the vantage point of the U.S. Embassy in Tokyo. I believe this report to be substantially correct in its analysis and conclusions, and commend it to your study. This Commission intends to pursue this problem area with vigor for the benefit of our foreign trade.

U.S. Great Lakes/Mediterranean Trade

The staff has recently concluded its informal negotiation with the American Great Lakes Mediterranean Eastbound Freight Conference wherein the previously existing ocean freight rate disparities on 15 moving commodities have either been eliminated or substantially reduced. Eight of the commodities involved rates from U.S. Great Lakes ports which discriminated against American exporters in relation to rates offered by the same carriers from Canadian ports. Seven of the commodities involved discriminatory rates on the basis that American exporters have been paying considerably higher rates than those which were assessed for the movement of the same commodities in the opposite direction of the trade. Listed below are the commodities wherein corrected rate action has been taken to either eliminate or substantially reduce previously existing disparities. It is hoped that the rates now available to American exporters on these products will enable them to maintain and improve their competitive marketing position in the Mediterranean area.

Acid, Fatty	Magnesium Oxide	Iron & Steel Nails
Buildings	Resin, Synthetic N.O.S.	Iron & Steel Wire
Canned or Bottled Goods	TV Sets	Office Machines & Parts
Hides	Automobiles	Medical Apparatus
Machinery (Packed)	Hand & Machine Tools	Sound Recorders & Parts

In addition to obtaining corrected rate action on the specific commodities at issue, the Conference has passed a resolution fully acknowledging its responsibility to fix rates in the Great Lakes/ Mediterranean trade which do not discriminate against American exporters by way of freight rate disparities. We have been assured

by the Conference that in all future rate deliberations it will give due regard to rate levels applying in the reciprocal portion of its trade as well as those from Canada to the same markets. The Conference has advised us that every reasonable effort will be made to insure against the future creation of rate disparities which cannot be justified by valid transportation conditions.

Enclosure No. 3 is a copy of a decision issued by one of the Commission's Hearing Examiners on May 19, 1971, in Docket No. 70-12, Commodity Credit Corporation, and United States Agency for International Development v. American Export Isbrandtsen Lines, Inc., Et Al.* I feel that this decision will be of interest to you since it involves the complaint action filed with this Commission, wherein U.S. Government agencies alleged that the respondent carriers, as members of the Great Lakes Mediterranean Eastbound Freight Conference, were assessing discriminatory freight rates on Agricultural commodities moving from U.S. Great Lakes ports versus Canadian ports. You will note that in this particular case the Hearing Examiner finds that the rates involved do not violate the discriminatory provisions of the Shipping Act, 1916. Under the Commission's rules of practice and procedure this initial decision of the Examiner does not become final for 30 days after its publication, pending the right of protest by interested parties and the right of the Commission to review.

U.S. North Atlantic/Continental Trades

In my letter to Senator Long, I mentioned the Commission's service of orders to "show cause" on five carriers serving the U.S. North Atlantic/European trades. While these proceedings are technically still formally before the Commission, I can say that favorable resolution of many of the disparately rated commodities has already been achieved. Enclosure No. 4 is a copy of a news release issued by the Commission on May 3, 1971,* noting that the North Atlantic Continental Freight Conference reduced or eliminated the disparities on twenty-two export commodities which are included in the "show cause" proceedings. It thus appears that the Commission's experiment with the "show cause" procedure was a worthy one which now establishes a precedent upon which we can base future efforts to achieve more responsive action in the area of disparity elimination.

*These documents are made a part of the official files of the Subcommittee.

The apparent effectiveness of the "show cause" proceedings has had the side benefit of allowing the staff to enter informal negotiations with all of the carriers in the North Atlantic/ Continental trade (both conference and nonconference) to obtain similar results without the time and expense of formal proceedings. It is expected that these negotiations will be successfully concluded in the near future.

U.S. North Atlantic Ports versus Eastern Canadian Ports to Foreign Destinations

The staff has been engaged in an ever widening analysis of U.S. exports and imports moving through Canadian ports instead of our own domestic port systems. Thus far, the tariffs of the Canadian conferences which publish rates to the United Kingdom, Continental Europe and Australia have been compared with the comparable conference tariffs applying from the U.S. North Atlantic ports.

In the European trade, the most significant disparity discovered appears to be the rates applicable to hardwood lumber moving from Canada as opposed to those applicable from the U.S. Great Lakes ports. The staff is pressing the U.S. Great Lakes Bordeaux/Hamburg Range Eastbound Conference for a prompt elimination of this situation. Most of the other rates published in this trade are competitive.

The comparison of the tariff of the U.S. Atlantic & Gulf/Australia-New Zealand Conference with that of the Canada/Australia-New Zealand Conference revealed approximately twenty commodities to be subjected to substantial disparities favoring the Canadian ports. The staff is beginning an effort to speedily eliminate these disparities through negotiation with the U.S. domiciled conference. If the conference does not respond promptly, the staff is prepared to recommend formal Commission action in this trade also. A shipper of outboard motors advised the Commission of his inability to continue to utilize U.S. ports for his shipments to Australia because of the much lower rates available through Canada. The staff placed this problem before the Conference which promptly reduced the rates from U.S. ports and the cargo continues to flow through the U.S. transportation and port systems. We expect similar action on most, if not all, of the other commodities involved in this effort.

The comparison of the tariff of the Canada-United Kingdom Freight Conference with that of the United States North Atlantic United Kingdom Freight Conference reveals a large number of commodities which are rated in such a manner as to favor Canadian ports. Here, too, the staff plans to call these disparities to the attention of the North Atlantic United Kingdom Freight Conference with the request for expeditious elimination. If necessary, the Commission will consider formal action.

A more detailed report on the problem of U.S. cargo diversion through Canadian ports is contained in Enclosure No. 5 for your study.* I have removed two portions of that report which contained information furnished to us on a confidential basis, pending public disclosure by the parties involved. The removal of these portions does not detract from the value of the staff report in any manner. As you will note from the report, the published freight rates of the ocean carriers are only part of the overall problem. The Canadian tariffs themselves have clauses to the effect that the rates "do not necessarily apply" to cargoes which originate in the United States. Also, the Canadian steamship lines appear to be absorbing the costs of overland transportation from Montreal and Toronto to the more eastern ports of Halifax and St. John. There will be no easy solution to this problem of "cargo leakage" through the ports in Canada, but this Commission is determined to do all within its power to alleviate overt discriminations committed by carriers subject to our jurisdiction.

U.S. North Atlantic/Baltic
Scandinavian Trade

The staff has analyzed the North Atlantic/Baltic Scandinavian trade in an effort to identify ocean freight rate disparities which appear to discriminate against the American exporters in relation to shippers exporting from the Baltic Scandinavian area to the United States. From this effort, the staff has compiled a list of approximately 90 commodities which appear to represent substantial disparities weighted against American shippers. The staff is presently in the process of obtaining information relative to the volume of movement of these commodities in both directions of the trade. The staff is giving consideration not only to the volume in which a commodity might actually be moving but to the question of whether it might have a potential for movement. I am informed by the staff that it will shortly complete its

*This document ia made a part of the official files of the Subcommittee.

analysis of this particular trade, at which time the conference and carriers involved will be approached with a view toward obtaining elimination of the disparities involved on a voluntary basis. If this effort does not succeed, the staff will recommend that the Commission consider formal action.

I assure you that the Commission fully shares your concern over freight rate disparities. We are working diligently to protect the national interests in this area of foreign trade and our balance of payments position. We will relentlessly continue these efforts so long as a single American export is disadvantaged by discriminatory ocean freight rates.

I would like to mention the fact that while not reflected in this report as an achievement in connection with our rate disparity activities, considerable staff effort goes into analyzing the segments of our oceanborne international trades in the interest of protecting the American exporter. For example, the staff recently concluded a study of the American West African and South and East African trades to determine if inbound/outbound rate disparities exist. The conclusions were that disparities do not exist in these trades, primarily because the African nations do not produce and ship the same types of commodities as American shippers. Upon reaching this conclusion the staff concluded its efforts in these trades. However, we are constantly on the alert for any specific instance where rates may represent a marketing impediment to our shippers.

I would welcome any suggestions or comments you care to make in this matter.

Sincerely,

Helen Delich Bentley

Helen Delich Bentley
Chairman

Enclosures

Enclosure No. 1

FEDERAL MARITIME COMMISSION,
Washington, D.C., February 10, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I am indeed pleased to have your letter of January 21, 1971, and the opportunity which it affords to apprise you of the activities of the Federal Maritime Commission in combating discriminatory ocean freight rates in the foreign commerce of the United States.

The Commission's authority over freight rate levels in our foreign, oceanborne trades is essentially prescribed by the Shipping Act, 1916, as amended. Accordingly, its rate authority is limited, as opposed to that afforded by public utility-type regulation. If a rate is filed with the Commission in the form and manner prescribed by governing tariff filing rules, that rate must be considered as lawfully published and allowed to take effect. Hence, the Commission cannot suspend or disapprove any rate at the time it is filed. Its rate authority is limited to action after notice and hearing and upon a finding that the rate constitutes a statutory violation.

Section 17 of the Act provides that the Commission may, after notice and hearing, disapprove certain unjust discriminations between shippers and ports, or disapprove a rate found to unjustly discriminate against an American exporter, as compared to his foreign competitor. Section 18(b)(5) requires the Commission to disapprove a rate or charge which, after hearing, it finds to be so unreasonably high or low as to be detrimental to the commerce of the United States.

Under Section 15, the Commission is authorized to approve conference and other anti-competitive, intercarrier agreements. That section charges the Commission with disapproving or modifying any such agreement which it finds, after notice and hearing, to be detrimental to the commerce of the United States, contrary to the public interest or to otherwise operate in violation of statutory provisions. In order to carry out its responsibilities under Section 15, the Commission maintains close surveillance over conference rates and practices. Restraints on excessively high freight rates caused by anti-competitive actions can best be accomplished by insuring a degree of nonconference competition and by the exercise of our limited statutory powers to disapprove unjustly discriminatory or detrimental rates. The Commission does not feel constrained to approve agreements which give advantage to foreign shippers. The Commission would not nor could it knowingly approve such an agreement. All parties seeking the Commission's authority under Section 15 are required to demonstrate a transportation need for the agreement prior to its approval and to furnish indication that the agreement will operate in the public interest. I stress the fact that the Commission's power over rates in our international trades is limited to action only after hearing and upon a finding of statutory violation. This is true regardless of whether the rates are fixed by an independent carrier or by a conference of carriers operating under Section 15 authority.

I am setting forth below a brief summary of formal investigations conducted by the Commission involving ocean freight rate disparities which were weighted against American exporters:

In Docket No. 1114, *Iron and Steel Rates, Export-Import*, 9 F.M.C. 189 (1965), involving rate disparities on iron and steel products, the Commission set forth guidelines which for the first time established a standard for testing rates under Section 18(b)(5) of the Shipping Act, holding that under that Section, "When a rate disparity in reciprocal trades, on similar commodities appears, and when movement of goods under the higher rates has been impaired, the carriers quoting the rates must demonstrate that the disparate rates are reasonable." Under this decision, the burden of demonstrating that the higher rate is reasonable is placed on the respondent conferences or carriers rather than on the complaining shippers or the Commission's staff.

In Docket No. 1171—*Outbound Rates Affecting the Exportation of High-Pressure Boilers (Utility Type), Parts and Related Components*, 9 F.M.C. 441 (1966), involving a situation where rates on high pressure boilers from

U.S. ports to certain foreign destinations were higher than rates on the same commodity from foreign sources of supply to the same foreign destination, the Commission again set forth guidelines which for the first time indicated the manner in which the reasonableness of our export ocean freight rates under these circumstances would be measured. The Commission stated, "where a rate disparity is shown between a rate from the U.S. and a rate from a foreign port to the same destination on similar commodities, and the movement of goods under the higher rate has been impaired, the carrier quoting the rate from U.S. should demonstrate the reasonableness of the rate by showing that the transportation conditions in the two trades are not the same in material respects or that the attendant transportation circumstances require that the rate be set at that level."

In Docket No. 65–45—*Investigation of Ocean Rate Structures in the Trade Between United States North Atlantic Ports and Ports in the United Kingdom and Eire*, the Commission found that: (1) An unreasonable rate is one which does not conform to the ratemaking factors of cost, value of service, or other transportation conditions; or a rate which cannot be justified by one or more of these factors, (2) An adverse party may show prima facie unreasonableness by reference to a lower rate on a similar commodity which moves in a reciprocal or competitive trade, and (3) A rate which is detrimental to commerce is one which causes some economic harm to a segment of our commerce. The Commission disapproved certain outbound rates and ordered the outbound conference to file lower rates with justification of the level of the rate based upon cost, value of the service, or other transportation conditions. In this proceeding the Commission amplified its position in Dockets 1114 and 1171. The Commission stated it would not restrict the definition of detriment to commerce to those rates which prevent a commodity from moving but rather defined detriment as something harmful, not limited to lost sales or or other rigid formulas.

Copies of the Commission's decisions in these proceedings are attached.

Following the Commission's decision in Docket 65–45, the issues were reviewed by the Court of Appeals for the District of Columbia Circuit, which sustained the Commission's position. It was at this point that the Commission felt it had established a clear legal basis to effectively deal with discriminatory rates manifested by reciprocal or third market disparities. This was by the establishment of regulatory criteria under Section 18(b)(5) where the mere existence of a disparity weighted against the American exporter and his ability to show some harm thereby, shifts to the carrier or conference the responsibility to show the high export rate to be statutorily reasonable.

Accordingly, the Commission ordered its staff to embark upon a viable program to combat rate disparities, using the criteria established in Docket 65–45 and affirmed by the Court. Basically, the program involved obtaining vessel manifests which identify American exporters and the commodities they ship. Tariff rates are compared to identify disparities because of higher export rates and letters are disseminated to the exporters to determine the extent to which they are being harmed by such rates. Once the rate disparities are coupled with a showing of shipper harm, the conference is requested to eliminate the disparities by appropriate reductions in the export rates or to provide appropriate justification for such rates.

Outlined below is a brief report on the results of the staff program to date:

UNITED STATES/JAPANESE TRADE

Letters were directed to hundreds of exporters marketing in the trades served by the Far East and Pacific Westbound Conferences (from U.S. Atlantic, Gulf and Pacific Coast ports to ports in Japan). The staff entered into informal negotiations with the Far East Conference, looking for remedial action by that group. The Conference has voluntarily reduced its rates on 10 commodities, eliminating or substantially reducing the disparities. It has furnished what it considers to be justification for the remaining disparity items. The Pacific Westbound Conference has not yet taken any action nor has it provided us with justification. The staff reports that its presently compiled list of rate disparity items in the Japanese trade involves over 150 commodities and that it intends to recommend a formal Commission investigation unless the disparities are promptly and voluntarily eliminated or justified by the Conferences.

U.S. NORTH ATLANTIC/FRENCH NORTH ATLANTIC TRADE

The staff compiled a list of 13 disparately rated commodities seriously weighted against our exporters. After considerable, informal negotiations, the export conference voluntarily reduced its rates on the 13 items, thereby eliminating or greatly reducing the disparities.

U.S. GREAT LAKES/MEDITERRANEAN TRADE

The staff analyzed the rates from U.S. Great Lakes ports to the Mediterranean Sea area with those in the opposite direction and those from Canadian ports to the same area. It identified a total of 15 moving commodities where serious rate disparities exist either on a reciprocal or third market basis. The conference from U.S. Great Lakes ports has been requested to eliminate the disparities by reducing its rates or provide us with acceptable justification. Further, the conference has been asked to undertake an analysis of existing disparities with a view towards elimination of those not justified by valid transportation conditions and to provide us with the results of its study. The season of navigation from U.S. Great Lakes ports is presently closed. However, the staff expects to conclude this segment of its program in the near future, certainly prior to the opening of the 1971 navigation season.

U.S. NORTH ATLANTIC PORTS VERSUS CANADIAN ATLANTIC PORTS TO UNITED KINGDOM AND AUSTRALIA

The staff has recently obtained tariffs published by the conferences from Canada to Australia and the United Kingdom. The purpose is to analyze these foreign-to-foreign rates for third market disparities in connection with rates from U.S. Atlantic ports. There is here a concern as to the extent to which the rates and practices of the carriers serving our foreign commerce might be discriminating against our exporters by offering lower rates from Canadian ports and thereby encouraging U.S. origin cargoes to move through the Canadian transport systems. While this particular aspect of our staff program is in its early stages, I will insure that it is conducted as effectively and as promptly as possible in order not to delay any needed remedial action on the part of the Commission.

I might mention that one of the difficulties generally experienced by the staff in carrying out its informal program is the apathy on the part of shippers. For example, out of literally hundreds of letters sent to shippers in the Japanese trade, a relatively small number indicated the export rates to represent a serious problem. Seldom do shippers present cogent facts to support a showing of harm by the level of rates. Many merely indicate they could do more business with lower rates. In the Japanese trade only about a dozen shippers followed our suggestion of asking the conference for rate relief as a first step. The Commission has attempted to educate shippers in the art of seeking relief to their ocean shipping problems. We have worked through other federal agencies, the Export Expansion Councils, trade associations and other shipper groups. The Commission and the Department of Commerce have jointly published a booklet entitled "Ocean Freight Rate Guidelines for Shippers" to assist shippers in seeking solutions to their shipping problems. A copy of the current issue of this booklet is attached. It is expected that a revised and improved edition will be published later this year. The booklet has been given wide distribution by the Department of Commerce and this Commission.

In addition to programming trades to combat rate disparities, the staff also analyzes every complaint received from shippers involving an export rate to determine the existence of a disparity and to seek appropriate remedy. Conferences are required by Commission order (General Order 14) to submit to us quarterly reports of their requests and complaints from shippers. When shippers ask the conferences for rate adjustments which are denied, the staff checks for disparities in order to require the conference to lower the export rate or justify its existence pursuant to our regulatory criteria. From time to time these efforts result in the elimination of disparities.

In 1968, following the longshoremen's strike at U.S. Atlantic and Gulf ports, conferences serving those ports published strike surcharges, purportedly to compensate them for strike-related losses. In spite of its limited authority over rates, the Commission made extensive informal efforts to insure that the surcharges

were warranted and applied in a nondiscriminatory manner. The Commission served the conferences operating in U.S. North Atlantic/Continental European ports with an order to show cause as to why the fact that a 10% strike surcharge on American exports to Europe, whereas no strike surcharge on European exports to the United States was being assessed, should not be found to be unjustly discriminatory in violation of the statute. The export conference cancelled its surcharge and the proceedings was ultimately dismissed. Subsequently, the conferences from U.S. North Atlantic ports to the United Kingdom, French North Atlantic and Baltic/Scandinavian areas, voluntarily cancelled their strike surcharges to avoid formal Commission action.

Recently, the Commission served show cause orders on five carriers serving the North Atlantic/European trade, i.e., Sea-Land Service, Inc., Seatrain Lines, Inc., American Export Isbrandtsen Lines, Inc., Hapag-Lloyd and Atlantic Container Lines, Ltd. Copies of these orders are attached. As you will note from the orders, each of the carriers is publishing rates on the same commodities which are very substantially higher from the United States to Europe than those in the reverse direction. These proceedings represent the first time that the Commission has attempted to test the question of rate disparities by a show cause order. Should the Commission be able to sustain its position through the vehicle of a show cause proceeding, it will possibly then have established a new and more effective means of combating rate disparities throughout our foreign trades. You will appreciate that I cannot substantively comment on the issues involved in these proceedings since they are formally before the Commission for adjudication.

You inquire as to possible Commission recommendations for additional legislative authority to combat discriminatory ocean freight rates. One legislative proposal which the Commission is presently considering is an amendment to the Shipping Act, 1916, to provide for written justification (at the Commission's discretion) of any new or initial rate or rate change by ocean carriers and conferences. The proposal would empower the Commission to suspend (for a period not to exceed 180 days) and investigate any new or changed rate which, in its discretion, is not properly justified as being not so unreasonably high or low as to be detrimental to the commerce of the United States, or inconsistent with the policy or provisions of the Act. The proposal would also give the Commission the power, after hearing and upon a finding that the rate is so unreasonably high or low as to be detrimental to the commerce of the United States, or inconsistent with the policy and provisions of the Act, to alter same to the extent it deems necessary. If the Commission acquires this added authority, it would then be in a much better position to forcefully and decisively deal with discriminatory ocean freight rates.

I assure you that this Commission shares your concern over discriminatory ocean freight rates and their impact on our international trade and balance of payments position. I believe that the Commission has made an effective contribution to the protection of these national interests. However, I welcome your interest and would be pleased to receive any suggestions which you or your Committee might care to make concerning our future operations in this area.

Sincerely,

HELEN DELICH BENTLEY, *Chairman.*

[Enclosure No. 2]

DEPARTMENT OF STATE—AIRGRAM

Unclassified

MAY 11, 1971.

To: Department of State.
From: AmEmbassy TOKYO.
Subject: Ocean freight disparities on United States-Japan routes.

SUMMARY

Ocean freight rates on many commodities from the United States to Japan are higher than the rates from Japan to the United States on the same or similar products. In many cases these disparities are large (disparities ranging from 20 percent to well over 100 percent are not unusual). Moreover, since duties are applied on a CIF basis, and commodity taxes on a landed duty paid basis, the

effects of the disparities are multiplied. The Embassy has attempted to examine the economic effects on U.S. exports of these disparities and several case studies are included. In some of these cases it appears that elimination of the disparity by a reduction in the U.S. outbound rate could significantly increase U.S. exports.

Enclosures:

(1) Resolution of American Chamber of Commerce in Japan regarding freight rate disparities

(2) FMC freight rate disparity program

The disparity situation

There are six conferences involved in U.S.-Japan shipping. Three are from Japan to (1) Pacific West Coast, (2) the Atlantic and Gulf coasts and (3) U.S. Great Lakes ports. Three conferences are from these areas to Japan. Each of the three routes is served by an outward and an inward conference, each of which establishes its own commodity descriptions and freight rates.

There are literally hundreds of commodity descriptions and freight rates established by these six conferences. To illustrate the existing disparities, the following rates were recently in effect between Japan and U.S. Atlantic and Gulf ports.

TABLE 1.—A COMPARISON OF OUTBOUND AND INBOUND RATES ON SEVERAL COMMODITIES

Commodity	Far East Conference outbound rate W/M [1] (to Japan)	Japan-Atlantic/Gulf Conference inbound rate W/M [1] (to United States)
Lamps, NOS and parts	87.00	[2] 38.75/46.25
Typewriters	88.25	50.75
Liquors, NOS	80.25	59.25
Cargo, NOS	88.25	[2] 54.00/74.00
Machines, coin operated	73.00	50.75
Dry paint pigments	62.00	[2] 49.25/42.00
Machinery and parts, NOS	73.00	50.75
Motors, outboard and parts	73.00	42.25
Machines, viz office NOS	88.25	[2] 38.50/61.00
Textile goods, NOS	88.25	43.50
Plastic sheets, including laminated	78.75	38.25
Synthetic resins	55.75/60.00	42.25

[1] W—2,000 lbs. (weight ton); M—40 cubic feet (measurement ton).
[2] Depending on value.

Adding to the incongruousness of the rate disparities themselves is the fact that membership of the freight conferences both outbound and inbound, is almost the same. For example, American President Lines and Mitsui O.S.K. Lines are members of both the outbound Pacific Westbound Conference and the inbound Trans-Pacific Freight Conference of Japan.

The origins of the disparity situation are obscure, but disparities have clearly existed for many years. One theory is that they arose prior to World War II due to the makeup of U.S.-Japan trade. Japan exported inexpensive goods which could not be shipped except at very low freight rates while U.S. high value exports could "carry" higher rates. Thus, disparities arose in order to permit the shipping lines to fill their ships in both directions. A second historical explanation is that disparities were initiated or continued after World War II as an effective form of economic assistance to Japan at a time when it could not compete on world markets.

The most common current justification for disparities given by the conferences is that the rates are set at "what the traffic will bear". In some respects this is true. The system of rate-setting appears to operate as follows. A general inbound rate increase is proposed, which produces strong resistance from Japanese exporters organized in the All Japan Exporters' Association and from selected U.S. import interests. The Japanese exporters invariably put pressure on the Ministry of International Trade and Industry and the Fair Trade Commission, which, in turn, pressure the shipping companies through the Ministry of Transport. Compromises are negotiated on individual commodity rates or on across-the-board increases. The strength of the pressure from Japanese exporters, compared with U.S. exporters, is so strong that increases on rates from Japan to the U.S. are almost always lower than increases on rates from the U.S. to Japan.

The situation is aggravated by the fact that Japanese shipping companies belong to industry groups which are among Japan's major exporters. Influenced by the industry groups, the Japanese companies inevitably vote in a block in conference meetings. If U.S. and third country lines were to vote together, they could block such moves, but individual companies are "bought off" and, in effect, the Japanese lines control the conferences.

U.S. Business Interest

The U.S. business community has been aware of ocean freight rate disparities in U.S.-Japan trade for some time, but it was only in recent months that it became a major issue. The relative quiescence of the issue has been due to lack of information and to the fact that traffic is normally handled by Japanese employees at this end and freight departments in exporting corporations. However, the recent pattern of expanded disparities has led the U.S. business community to draft a resolution which was passed by the ACCJ and forwarded to the conferences and the FMC. This resolution is at Enclosure 1. (Minor drafting changes may still be made in the resolution.)

While the local U.S. business interests would prefer to see a lowering of west-bound rates to east-bound levels, they would be interested in any increase in east-bound rates, since the companies they represent face serious import competition in other product lines. An example of this is one large U.S. chemical company which exports millions of dollars of U.S. goods to Japan, but faces serious Japanese competition in the U.S. market in other product lines. Whether an elimination of disparities were to result in a reduction of west-bound rates or in an increase of east-bound rates, the U.S. company would benefit.

The position of the U.S. shipping lines on this question is relevant. When the issue was raised initially, they opposed and attempted to block consideration. More recently several have cooperated with Embassy and American Chamber of Commerce in Japan efforts and much of the information contained in this airgram is based on their comments. They prefer, however, not to take an active role due to their fear of economic retaliation by Japanese shippers. Of course, they would prefer to see east-bound rate increases to west-bound decreases.

Economic Effects of Rate Disparities

Ocean freight rates from the U.S. to Japan are high and increasing. The across-the-board rate increases of the past few years have been as follows:

TABLE 2.—FREIGHT RATE INCREASES ON UNITED STATES-JAPAN ROUTES, 1969–71

[In percent]

	Pacific		Atlantic gulf		Great Lakes	
	Out	In	Out	In	Out	In
1969	7		7.0		7	5
1970	7–10	9	12.5	7.5		
1971	[1] 10–15					

[1] As of June 15, 1971.

Increases on the outbound routes have been generally higher than increases on the inbound routes. Even if overall percentage increases were roughly equal on both inbound and outbound routes, existing disparities would be increased, since the U.S. outbound rates are higher to begin with.

One effect of the rate disparities is to increase the costs of U.S. products in Japan. In 1969, the most recent year for which data are available, the percentage of ocean freight and insurance costs to total costs of U.S. goods delivered in Japan was 18 percent. Ocean freight costs account for almost all of this. Adding to the final cost of U.S. goods in Japan is the fact that Japan, like most other countries, charges duties on a CIF basis and that various internal taxes are charged on a duty-paid landed cost.

Given this situation, it is obvious that a reduction in the high ocean freight rates from the U.S. to Japan would result in a cost reduction equal to the freight cost reduction plus a reduction of duties and taxes paid on U.S. goods. One U.S. businessman in Tokyo estimated that if he could lower his landed costs by around 18 percent, his sales volume would increase by 35 to 40 percent.

Examples of Economic Effects of Rate Disparities

In the absence of complete data on the extent of disparities it has been impossible for the Embassy or the business community here to prepare a meaningful economic analysis of the effects of the rate disparities. Moreover, the extreme complexity of each conference's rate structure makes comparison difficult. However, the Non-Tariff Trade Barriers Committee of the American Chamber of Commerce did prepare analyses of two cases to illustrate the effect of disparities.

The first analysis involved a piece of equipment shipped from San Francisco to Yokohama in April 1970. The ocean freight for this voyage was $875.41. Later the same piece of equipment was returned from Yokohama to San Francisco. The ocean freight for the return voyage was $615.08. The piece of equipment was the same; the freight differential was accounted for by the freight rate disparity. The outbound freight rate was $64.25 per weight or measurement (WM) ton; the inbound, $44.25 per WM ton. In discussions with the U.S. firm involved, which has offices in both the U.S. and Japan, the Embassy was told that if the outbound freight rate were the same as the inbound, the U.S. firm estimated that it would increase its sales volume by about 10 percent. This was a "conservative estimate".

The second case involved certain hydraulic equipment where the U.S. outbound rate is $73.65 per weight ton while the inbound rate is $58.50. The U.S. firm estimated that it could expand exports by well over $1 million if the outbound freight rate were lowered to the inbound level. This case is particularly interesting in that the firm applied for but was refused a freight rate reduction. The U.S. representative of the firm in Japan asserts that, while he would prefer a lowering of outbound rates, his firm faces severe import competition in the U.S. and would benefit from an elimination of the disparity by an inbound freight rate increase.

At a Heating, Air-Conditioning and Refrigerating Equipment Trade Show held recently at the U.S. Trade Center in Tokyo, Embassy officers discussed freight rate disparities with exhibitors, using 1970 data provided by the Federal Maritime Commission and the Far Eastern Conference. One exhibitor, whose company produced upright freezers, said that if the outbound rate were lowered to the level of the inbound rate, it would result in a 15 percent reduction in the landed cost of his refrigerators. The refrigerators in question cost $400 (FOB) each. Packed for shipping, they measure 60 cubic feet, or 1.5 measurement tons. The Far East Conference (outbound) rate for this item is $76 per WM ton; the Japanese-Atlantic/Gulf (inbound) rate is $34.75 per WM ton. This results in a disparity of $41.25 per WM ton. Since each refrigerator is 1.5 measurement tons, the disparity cost per unit is $61.87, which is 15.5 percent of the FOB cost of each refrigerator ($400). While the exhibitor could not estimate the sales effect of a 15 percent cost reduction, it would be considerable.

Conference policy on disparities

The conferences state that they are prepared to reduce or eliminate disparities in outbound rates if an economic case can be made that such action would lead to an increase in sales. They have not, to the Embassy's knowledge, ever established a more favorable rate for outbound than inbound commodities although there are hundreds of commodities where inbound rates are lower than outbound.

The U.S. business community resident in Japan is extremely skeptical about the actual willingness of the conferences to eliminate freight disparities by lowering outbound rates. This skepticism seems to be borne out by the facts. For example, in early 1970, the Far East Conference was asked by the FMC to explain the disparities in the outbound and inbound rates on forty-two items. On every item, the outbound rate was higher.

In its reply to the FMC, the Far East Conference claimed that there was no disparity in every one of the forty-two cases. In twenty of the cases, the FEC cited an increase in U.S. exports as proof that a higher outbound rate was justified; on the other hand, the FEC also claimed in a few cases that high and increasing level of U.S. imports showed that a lower inbound rate was justified. Twice the FEC claimed that declining U.S. exports justified the higher outbound rate.

Another argument often used by the FEC was that there was no disparity unless the goods were identified both in content as well as price. Therefore, if U.S. goods were larger or higher priced per unit than Japanese goods, it was claimed that freight differentials are justifiable.

Japanese Government policy on disparities has not been enunciated formally for several years. However, informally, the Government supports the conferences and maintains that rates are set at what the market will bear and there is no policy by either the conferences or the Japanese Government to utilize rate disparities to restrict U.S. sales in Japan. No explanation is given why "what the market will bear" has invariably resulted in freight rate disparities in one direction.

Conclusions and recommendations

While the freight rate disparities problem has existed for many years it has only received active consideration in the last few years. As duties both in Japan and in the United States decrease and the freight rates rise, the absolute and relative importance of disparities increases.

The Embassy is inclined to accept the Japanese Government assertion that there is no "policy" on rate disparities. The disparities have arisen due to historical reasons and the better organization of Japanese export and shipping interests. The question would appear to be not who is to blame but what can be done about the situation.

The recent visit of Federal Maritime Commission Chairman, Helen Bentley, and the General Manager of the FMC, Aaron Reese, has beeen extremely useful in this connection in clearly demonstrating to the Japanese Government and shipping interests that something should be done to eliminate disparities (see Enclosure 2). Although working-level Ministry of Transportation officials were at first inclined to maintain that the freight rate disparities problem was one for the FMC to work out together with the conferences, particularly outbound conferences, Shipping Bureau Director-General Suzuki over-ruled them and said that the Ministry of Transport would cooperate with the FMC on this problem. He agreed to the formation of a U.S.-Japan working group in Washington to investigate rate disparities.

The degree to which conferences and the Ministry of Transportation are prepared to cooperate remains to be seen. However, the clear power of the FMC to disapprove rates which unjustly discriminate against U.S. exporters gives the FMC considerable strength vis-a-vis the conferences. In addition, the FMC's authority to approve or disapprove Japanese shipping companies' arrangements to provide joint service to the U.S. should give an incentive to the Ministry of Transportation to cooperate through its "administrative guidance" to Japanese shipping companies.

The Embassy believes that the decision of the FMC to continue its investigations of ocean freight rate disparities would be extremely useful.

To support the FMC's efforts, consideration might be given to Congressional action to amend the Shipping Act to make the existence of freight rate disparities on the same or similar products *prima facie* evidence that rates on these products are a detriment to the commerce of the United States. If the Congress amended the Shipping Act so as to make the existence of freight rate disparities on the same or similar products *prima facie* evidence that the rates were demental to U.S. Commerce, it might hasten the elimination of the rate disparities.

As was discussed with Chairman Bentley, in considering the applications of Japanese shipping companies to provide joint service, freight pooling agreements, etc., between Japan and the United States, the FMC might restrict the time period for which it approves the arrangements. For example, if Japanese shipping companies submit joint service or pooling agreements for FMC approval, the agreements might be approved for only one or two years. Such a restricted time period would indicate to the Ministry of Transport and to Japanese shipping companies that the FMC desires their cooperation in eliminating rate disparities.

Finally, it would be useful if the FMC would continue its efforts to simplify commodity descriptions. As was outlined by Chairman Bentley, in the age of containerization, commodities may be classified simply as "Class 1", "Class 2", etc., rather than by specific commodity name. The classifications could be based on the weight and values of one container filled with a commodity. For example, if 1,000 Japanese typewriters, weighing 20,000 pounds and with a total value of $50,000 can be carried in one container and 500 U.S. typewriters, weighing 20,000 pounds and with a total value of $50,000 can be carried in the same container, then these commodities should fall under the same commodity "Class".

Then, a flat rate per one container of this commodity "Class" could be established, which would be the same rate for both directions.

The Embassy, with the FMC's help, will continue its work with the U.S. business community in Japan and Japanese importers in attempting to identify, and to assess, the economic significance of individual rate disparities. In this connection, the Embassy would appreciate receiving one copy of each of the outbound shipping conferences' freight rate schedules.

MEYER.

Appendix G

Statement by the Special Trade Representative on Border Taxes, April 1968*

*Referred to at page 242 of these hearings.

Statement by Representative of United States on Border Taxes Before GATT Working Party, April 30, 1968

The United States welcomes the convening of this Working Party. We realize that the examination we are about to embark upon will be complex, and that fundamental policy issues regarding governmental intervention in trade will be raised. Nonetheless, we believe that it is essential at this time that the entire question of border tax adjustments be re-examined, and we hope that the appearance of such strong delegations is an indication of the desire of all of us to deal with this problem constructively and expeditiously.

When the present GATT language was drawn up more than two decades ago, the question of border taxes did not appear to be a major one. Levels of indirect taxes were much lower. Under these circumstances, overlying simple and sweeping assumptions about tax shifting seemed acceptable, and already existing practices were incorporated without searching examination. The rules were drafted in very general terms. The United States at that time had no pressing reasons for seeking more elaborate provisions which provided more equitable safeguards for its trading position. On the contrary, at that time the United States was conscious of the need to assist other countries in relieving the pressures of the so-called dollar gap and the requirements for postwar reconstruction. Little detailed attention was paid to a problem which might hypothetically arise which would be harmful to our then strong payments position.

Times have changed, and the United States must now pay very careful attention to rules and practices which are unfairly prejudicial to our trading interests. As President Johnson stated in his 1 January statement on this issue, "We must now look beyond the great success of the Kennedy Round to the problem of non-tariff barriers that pose a continued threat to the growth of world trade and to our competitive position".

More generally, the effect on trade of border tax adjustments and other nontariff barriers is relatively much more important multilaterally now than when the GATT was drawn up. Since that time, tariffs have become considerably less of a hinderance to trade, and quantitative restrictions have been substantially reduced in number and scope. Border tax adjustments have been placed in sharper focus by these developments particularly since there has been a steady increase in the rates and coverage of indirect taxes in many important trading countries. Most of this increase has been reflected in higher border tax adjustments. In some cases these rates are very high and cover almost all traded products. Consequently, in some countries the border tax adjustments on many items are well in excess of the tariff rate, and changes in border tax rates may often dwarf recently negotiated trade concessions.

When the current practices were in their early stages of development, principally after World War I, indirect taxation tended to be confined to sumptuary taxes on a limited number of goods or to low-rate general taxes. Border tax problems were then simpler and relatively little attention was paid to the border tax issue. Now, the general growth of indirect taxes has made prominent the issue of border tax adjustments, and a major re-examination is essential. But the problems have recently been further accentuated by the series of upward changes in border tax adjustments which have taken place in the past few months, and by the variety of new changes contemplated by various member countries of this Working Party. These changes, coming as they have at a time when the international balance-of-payments adjustment process is already under strain, have exacerbated a serious multilateral trade and payments adjustment problem.

For some time now, both in international organizations and in bilateral consultations, United States representatives have indicated a growing concern over the present arrangements on border tax adjustments and their effects on trade. As early as July 1963, the United States proposed in the Organization for Economic Co-operation and Development a comprehensive study of the problems of border tax adjustments and their effect on trade. Our concerns are well-documented in the various discussions and consultations held in that Organization. Also, in the GATT during the past several years, United States representatives have at various times suggested that this problem needed to be explored more fully. Since these adjustments are governed principally by the GATT, under Articles II, III and XVI in particular, we believe that a GATT review of its own rules is now in order. We believe that the Working Party should review the relevant rules in these articles with a view toward amending them or reaching new agreement on their interpretation and application in light of the current world trade and payments situation and of the need to improve the GATT in our continuous search for fairer trading rules and practices.

We have not come to this Working Party with fixed and inflexible views as to the results it must achieve. We wish the discussion to be a wide-ranging one. There will undoubtedly be other members of the Working Party who will wish to raise aspects of the problem which have not yet occupied us, or to present substantive argumentation to develop points that we have made. We shall welcome such contributions.

There are several general problem areas with which we should like to deal in this Working Party.

First, we should like to have a serious comprehensive discussion of whether there should in fact be border adjustments to compensate for national differences in taxation. There are no adjustments for a wide range of government measures which directly affect prices, nor for many forms of taxation which affect prices. Why then should governments make specific border adjustments for certain types of taxes? When governments adopt new domestic economic policies which have side effects on trade or payments, domestic action is not necessarily accompanied by offsetting action to neutralize the balance-of-payments effect. Many government actions, for example, affect general price

levels. But only in the case of indirect tax measures is there an institutionalized provision for such offsets. What is the characteristic of indirect taxation that makes it uniquely qualified for automatic border adjustments?

If there are to be border adjustments, then they should be designed to allow no more adjustment at the border than is warranted by the impact on prices caused by taxes. From this point of view, we doubt that the current GATT rules and border tax practices are a good approximation of reality. The underlying assumption of the current rules is that certain kinds of indirect taxes are always fully passed forward in prices to the ultimate buyers of those goods, but that direct taxes and other indirect taxes are never passed forward to the buyers of those goods. Several issues arise out of this theoretical distinction.

Under present rules, it is unclear whether certain border tax adjustments are legal or not. In the first place, the definitions of direct and indirect taxes are by no means unanimously agreed. The GATT itself does not refer to the distinction, and the report of the Experts Group on this question is ambiguous in many respects. This is not surprising. Even today, economists have difficulty in defining direct and indirect taxes, depending upon the conceptual framework within which they are working and the purpose for which they wish to find definitions. The distinction between taxes which are shifted and those which are not is generally considered insufficient for analytical purposes and distinctions are often made between taxes which are meant to be shifted (whether they are or not) and those not so meant; between taxes on expenditures and taxes on receipts, and taxes on business enterprise as opposed to taxes on individuals. There are many examples: some authorities consider property taxes as direct, and others consider them indirect; some authorities consider employer contributions to social security as direct and some as indirect. In the second place there is wide diversity of opinion of just which taxes are "levied on" or "borne by" goods. The practice of certain countries varies significantly from the practice of other countries on this point. In the third place, under current rules, countries have had difficulty in assigning precise border adjustments to products in relation to taxes on those products. Averaging has often been used to determine the precise amount of adjustment at the border for some taxes removed from the last stages of production. The averages, because of the nature of the problem, have sometimes been based on sweeping and dubious calculations. The current system allows, and perhaps even encourages, imprecise arithmetic to determine the amount of adjustments. In these cases, imprecision often can mean continuous pressure for upward adjustments as a result of protectionist desires.

Putting aside these problems of classification and impression, there is a fundamental issue. Even when one is talking about relatively easily classifiable taxes, such as income and sales taxes, the economic validity of the distinction implied by the GATT between direct and certain indirect taxes is open to serious question. We think it is a fair statement to say that economists generally believe that indirect taxes are neither always nor fully shifted forward, and that direct taxes are seldom borne fully by the producer. There are differences of view on the extent of forward shifting of direct and indirect taxes but the extreme assumptions underlying the present GATT provisions are

patently wrong. Therefore, a border adjustment equivalent to the full internal indirect tax has the same effect on international trade as an export subsidy or an additional customs duty on imports. Similarly the failure to make border adjustments for that portion of direct taxes shifted forward into prices penalizes the domestic producer visia-vis his foreign competition, both at home and in export markets. This handicaps countries relying primarily on direct taxation.

Well-known economists and fiscal experts brought together in a symposium organized by the Secretary-General of the Organisation for Economic Co-operation and Development in September 1964 reached conclusions along these lines. In brief, the conclusions of the exports were: 1. "In practice, indirect taxes are not fully shifted into product prices . . ." and 2. "Certain direct taxes, and particularly the corporation profits tax, may be partially shifted into product prices, although the degree of shifting may vary from country to country."

Similarly, the Business and Industry Advisory Committee to the OECD (BIAC) in a report on the problem of tax shifting stated: "In a strongly competitive situation the prices obtainable—and hence the degree of tax shifting—are substantially determined by the market itself." The BIAC study on tax shifting found that while producers normally try to shift all taxes, their ability to do so is determined by a range of factors, including the state of the business cycle, the producer's control over his market, and institutional factors which vary from country to country.

Thus, it appears to my delegation that the GATT rules create the inequitable situation where indirect taxes which are not fully shifted forward to the consumer can be rebated on export but corporate income taxes which are shifted forward to the consumer cannot be rebated on export. The inequity also exists with respect to the use of compensatory import charges.

In summary, the present GATT provisions on border tax adjustments do not neutralize the effects of taxes on trade. Instead, they are export promoting and import restricting for the indirect tax countries. The basic assumptions underlying the GATT provisions are not realistic. The full border tax adjustment provided for with respect to indirect taxes constitutes both an export subsidy and an import surcharge. Adjustments for indirect taxes should be eliminated, or they should be reduced under carefully circumscribed conditions, or some comparable advantage should be granted to countries who do not have heavy indirect taxes to balance the advantages now granted to the indirect tax countries.

This brings me to the second basic, general problem area which we wish to have examined. That is the question of changes—that is to say, increases—in rates of border tax adjustments. Many countries have made or are making increases in their border tax adjustment rates. Some of the same countries, as well as a number of other countries, are planning to increase their border tax rates in the near future. These changes will raise obstacles to exports into their markets and give price advantages to their products in export markets. We are particularly concerned in cases where tariff concessions which we had obtained by reciprocal bargaining have been offset, or are currently threatened by new or increased compensatory import charges and by export rebates affecting other markets where we have received concessions.

These changes take two different forms, although they are sometimes mixed together: sometimes, changes are made on the argument that an adjustment from undercompensation to full compensation at the border is allowed. Sometimes changes are made in relation to a changeover from one system of indirect taxation to another system of indirect taxation.

Quite apart from the question of price shifting, changes raise fundamental problems. Once a country has established its rate of domestic taxation, its rates of border tax adjustment, its tariff rates, and its exchange rates, then any increase in the rates of border tax adjustment will create new advantages for the country's trade. Clearly, a change from so-called undercompensation to some higher, so-called full compensation level has markedly favourable effects on the trade of the country making such a change.

The changes which have recently taken place and which are soon to take place have intensified the balance-of-payments problem of my country. We believe that these changes have a fundamental adverse effect on the balance-of-payments adjustment process. The changes have been made even by countries which are in substantial payments surplus, and who ought to be seeking ways to avoid exacerbating balance-of-payments difficulties of other countries. The United States Government, in the framework of international co-operation, is presently seeking to achieve equilibrium in its balance of payments in a manner conducive, in the long term, to an increased flow of world trade. Increases in the level of border tax adjustment operate directly against these efforts. There is understandable interest in harmonization of their tax systems by the members of the European Communities. The shift from a turnover to a value-added system may be applauded as a tax simplification measure, but the increases in border tax adjustments which accompany such action can be harmful to the process of achieving a better pattern of multilateral payments balances.

In saying this we recognize the right of each country or group of countries to adopt any tax system it chooses. But, I repeat: the concurrent increases in border tax adjustments by surplus countries can be diseqlilibriating and contrary to the balance-of-payments adjustments which are needed internationally. Taking into account the basic problems which require new examination, and mindful of the urgencies brought about by the present and planned changes in the border tax adjustments of some countries, the United States Government respectfully requests that all countries contemplating changes in border tax adjustments refrain from increasing the level of their adjustments pending completion of the work of this Working Party. This is a difficult request to meet. We recognize the awkwardness it may create for certain countries. But we believe that these planned changes will very seriously exacerbate an already very difficult international trade and balance-of-payments situation, and that a standstill for the time being is a modest step compared wtih the general difficulties further rate changes may create for the United States, and for all countries.

A third general problem area which we believe requires careful and detailed examination is the ambiguity in present rules and the need for a more precise code of practices relating to present rules and any changes which might eventually be contemplated by this Working

Party. We are concerned with the ambiguities already referred to regarding distinctions between direct and indirect taxes. An attempt must be made to clear up what is legitimate and what is not. The question of what is meant by the terms "levied on" must be re-examined. Averaging and allocating practices should be examined. The valuation bases for assessment of border adjustments should be examined. Where a product is not produced in the home market, serious doubt exists that border adjustments should be made. Cases where production at home may be provided with special exemptions or escapes from taxes while at the same time requiring border tax adjustments on similar foreign goods should be examined. The broad scope for abuse of turnover tax systems, because of the ambiguity in them, should be examined. Ultimately, the question of what is "levied on" a product must be re-examined. New tax systems which might be adopted should be caught up in this basic review.

In order to assist other delegations in assessing the significance of present practices and the scope and dimension past, present, and projected developments in border tax practices in a number of countries, we shall make available to other delegations some descriptive information we have collected on border tax practices in a number of countries. We would welcome comments upon and additions to this compilation. Its purpose is to provide background as to why we believe the problems are growing in number, and why the work of this Working Party is a matter of urgency.

We would hope that in due course certain OECD documents can be released generally to members of this Working Party. Eventually, the documentation of this Working Party itself may grow large. The subject, as I said at the outset, is extremely complex. We believe, however, that it is extremely important, and that new approaches must be found, in spite of the great burden of work which it will place upon us.

The Working Party will in due course reach conclusions. We hope these conclusions will take the form of recommendations to change certain aspects of the GATT rules, and new interpretations of existing rules which might, perhaps, take the form of a Code, or a multilateral agreement of some kind. As I stated earlier, our ideas are not fixed. We would welcome suggested approaches by other countries. We are guided by certain broad considerations. We question whether there is a sound conceptual basis for any general border tax adjustments. If, however, it is a widely held view that some forms of border tax adjustments should continue, we believe that these border adjustments should not act in such a way as to give an unfair advantage to countries with one type of tax system and to penalize countries with other types of tax systems. If border tax adjustments are to serve the purpose of neutralizing the effect on trade of price and resource distortions caused by taxation systems, the rules should not have the effect of encouraging countries to adopt one sort of tax system over another sort of tax system, merely because the GATT rules on border taxes give trade advantages to one system over the other. We believe that a country generally should be able to choose its tax system primarily because of domestic considerations without regard to trade advantages conferred by GATT rules on certain tax systems. Finally, we believe that the border tax adjustments, and changes in them, should not be set or operated in such a way that they exacerbate the international balance-of-payments adjustment process.

Appendix H

United States-Japan Trade in the 1970's—A Strategy Analysis Prepared by the Boston Consulting Group, Inc.

U.S.-JAPAN TRADE IN THE 1970's

A Strategy Analysis

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U.S.-JAPAN TRADE IN THE 1970's

Summary

Close and cooperative relations between Japan and the United States are essential to maintaining a secure position for Japan and the U.S. in today's world. On this relationship depends the security of the North Pacific, and the feasibility of a viable order in the 1970's in Southeast Asia. Fast becoming an economic superpower, Japan is a large market for U.S. goods, and has been a dependable ally in maintaining the world monetary system in reasonable order.

Over the past two decades, while Japan has moved from the status of a client to that of an associate of the United States, the relationship has remained a close and cooperative one, despite the inevitable strains associated with a shift in status. And this has been true despite the fact that the two countries have little in common. Neither history, religion, culture, language nor race provide a basis for an identity of interests. Indeed, economic interests and their associate, military interests, have provided the real basis for cooperative efforts between the U.S. and Japan to date.

Yet relations between the two countries appear now to be in a state of rapidly increasing tension. This is especially hazardous since these tensions are building in respect to trade relations--precisely the area in which common interest is most widespread and most likely to be maintained. The inability of the two countries to find even a basis for real negotiations over the textile issue, much less reach agreement, is a clear signal that relations are in serious trouble. The response on both sides to this impasse has been a hardening of general positions.

The crux of the issue has been, of course, Japan's increasing export competitiveness in world markets, particularly for manufactured goods. Japan has broadened the spectrum of its penetration of the U.S. market from textiles to toys, steel, consumer electronics, motorcycles, and autos. In addition, it has replaced the U.S. as the main supplier of heavy equipment to such countries as Taiwan, Korea, and the Philippines. From the U.S. viewpoint, this situation has been further exacerbated by a shift of Japan's trade balance with the U.S. from deficit to a growing surplus.

Traditional mythology, which ascribes Japan's success to cheap labor and dumping, is not only wrong, but offers few analytical insights or constructive solutions to the basic economic issues involved. Rather, one must systematically examine differences in growth rates, cost declines, and rates of inflation to determine the economic dynamics at work. From this analysis it is possible to assess the strategic options open to Japanese or U.S. business independently or in concert with their respective governments.

It is recognized that demand and supply conditions for different industries in various countries change systematically as those countries develop. Each industry in each country evolves through a product cycle from no production to growth, maturity and finally decline. A country's industrial spectrum is constantly shifting with respect to industry development and competitiveness. These shifts are directly related to comparative movements down the industry experience curves, both internally and with respect to industries in other countries. Japanese and U.S. industries have been going through such a process for a long time, and the result of their interaction is apparent in present and past trade positions. A rational assessment of the process can indicate what will happen if present trends continue and also what key factors affect the evolutionary process. These factors would form the basis of any trade negotiations as well as any course of independent action. These are the strategic options.

The Problem

Japan's attitudes toward trade are largely the result of a century of effort to reach industrial parity, and a century of experience with a fragile balance of payments situation. As a result, Japan has tended to view all exports as a means of obtaining raw materials and as a means of debt serving. To this point in time, however, it has never considered trade as a means of obtaining goods for consumption at lower cost. The attitude underlying such a policy might be stated as follows: "We can do everything better than anyone else. Therefore, we should export everything and import as little as possible--raw materials and some machinery--until we learn to make it." Because of this irrational but real attitude, Japan has erected a large and complex network of barriers to imports.

The U.S., on the other hand, has for many years been dedicated to free trade as a policy. While consciousness of the economic advantages

of free trade has played its part, this policy also has its irrational elements. There has been a feeling that the industrial skills of the U.S. are great enough to ensure that under conditions of reasonably free competition, the U.S. is likely to outcompete other countries in any market it chooses to enter. In pursuing a free trade policy, the U.S. has for practical purposes failed to distinguish between products in terms of their desirability or cost as imports. In consequence, responses in trade negotiations have been essentially the result of current political pressures.

The developing trade between the U.S. and Japan is now producing economic and political pressures in both countries, pressures now rising to a danger point. These are the direct result on the one hand of Japan's successful implementation of its policies, and desire to continue them, and on the other of the U.S.'s comparatively unsuccessful competitive efforts in recent years. Since World War II, Japan has increased its share of world exports, almost totally in manufactured exports. Though this largely reflects a recovery of its prewar position, there is no abatement in its recent export growth rate. And, during the last decade, this has been two and one-half times that of the U.S. (16.3 percent versus 6.8 percent). The U.S., on the other hand, has been steadily losing world export market share. This was almost inevitable given the economic anomalies of the early postwar period. In recent years, however, U.S. export growth has continued below world averages, especially in manufactured goods (Exhibits 1 and 2).

The net result of this process has beer an increase in Japan's competitive export position vis a vis the U.S. from one-twentieth of U.S. exports in 1948 to roughly one-third in 1968. Yet, this fact still disguises the actual competitive situation as Japan's exports are almost totally manufactured goods (1968: 93 percent), whereas the U.S. exports large quantities of raw materials and agricultural commodities (1968: 30 percent). Therefore, in the world export market for manufactured products, where the two countries really compete, the U.S. is now only twice as large and is losing ground fast (6.1 percent growth versus 16.9 percent).

Interestingly enough, their relative positions in 1968 are not much different than in 1938, but the size of the world market for manufactured goods has increased enormously. In addition, the largest percentage of world exports is now manufactured goods and their share is continuing to increase. The Japanese are therefore increasing their world market share relative to the U.S. in the fastest growing world export market

EXHIBIT 1

TOTAL AND MANUFACTURED EXPORTS
(SELECTED YEARS)

(Current Million $)

Year	1938	1948	1958	1968
World Exports	22,700	57,500	107,900	238,700
% Manufactured	45.0 %	42.0%	52.0%	63.0%
U.S. Exports	3,094	12,545	17,755	34,199
% Manufactured	65.0%	67.0%	74.0%	70.0%
Share World Exports	13.6%	21.8%	16.5%	15.2%
Share World Mfg. Exports	19.6%	34.9%	23.4%	15.2%
Japanese Exports	1,109	258	2,877	12,973
% Manufactured	85.0%	87.0%	88.0%	93.0%
Share World Exports	4.9%	.4%	2.7%	5.4%
Share World Mfg. Exports	9.2%	.9%	4.5%	7.7%

EXHIBIT 2

AVERAGE YEARLY COMPOUND GROWTH
RATES OF DOLLAR VALUE

	1938-48	1948-58	1958-68
Growth World Exports	9.1%	11.1%	8.3%
Growth World Mfg. Exports	8.9%	8.9%	10.8%
Growth U.S. Exports	15.0%	3.5%	6.8%
Growth U.S. Mfg. Exports	15.4%	4.6%	6.1%
Growth Japanese Exports	(-15.7%)	107.5%	16.3%
Growth Japanese Mfg. Exports	(-15.5%)	106.7%	16.9%

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segment. This, as we shall note shortly, accelerates the improvement in their competitive cost position. A continuation of this trend will ultimately give Japan a larger share than the U.S. of world manufactured exports. For instance, by 1975 Japan's GNP may well be close to $400 billion in current prices. If she exports, say, 15 percent of her GNP, a reasonable figure given present trading success, the total value of exports will be $60 billion compared with $16 billion in 1969.

Concomitant with these world market developments has been an increase in Japan's share of total U.S. imports from 7.8 percent in 1960 to 13.6 percent in 1969 and of U.S. manufactured imports from 16.8 percent in 1960 to 21.2 percent in 1969. As significant as these developments are, however, they do not completely reveal Japan's current dominance of important U.S. imports such as textiles, steel, and consumer electronics that compete directly with U.S. producers (Exhibit 3).

When this dominance is viewed together with the increasingly unfavorable U.S.-Japan trade balance (Exhibit 4) and with Japan's slow-moving and ill-named "import liberalization" policy, the reasons for current tensions among American businessmen and government policymakers are readily apparent. On the other hand, Japan's desire not to change her success formula for trade, which has been a key factor in her remarkable postwar economic development, should be equally appreciated. Here we have the essence of the problem.

The important questions are these:

1. Are there any essential characteristics in terms of growth rate, industrial cost decline, or rate of inflation that will produce a continuing bias in Japan's favor in its trade balance with the U.S. and in its relative competitiveness worldwide?

2. Is there a basis for trade interaction between the two countries that is viable in the long run? What are the strategic options open to each country either unilaterally or jointly via negotiations to establish such a relationship?

3. If we assume that trade is to be brought to equilibrium either by monetary adjustment, or tariff differentials and other restraints, then the U.S. must know which of its exports are the most vital to encourage and

EXHIBIT 3

CONCENTRATION IN U.S. IMPORTS
AND JAPANESE EXPORTS (1969)

Japan's Percent U.S. Imports	13.6%
Percent Mfg. Imports	21.2
Percent Textile Imports	27.5
Percent Clothing Imports	22.8
Percent Steel Imports	45.8
Percent Auto Imports	9.0
Percent Motorcycle Imports	73.6
Percent Consumer Electronic Imports	74.6
Percent New Aircraft Imports	23.6
Percent of Japanese Exports going to U.S.	31.5

EXHIBIT 4

THE JAPANESE MARKET FOR U.S. PRODUCTS
($ million)

	1955	1960	1965	1968	1969
U.S. Exports to Japan	683	1,447	2,080	2,954	3,490
U.S. Trade Balance with Japan	+251	+298	-334	-1,100	-1,398

ensure market access and which are the least important to ensure market access. Conversely, the U.S. needs to know which of its industries are the most important to protect from imports and which are the least important to protect.

4. Since this is a question of trade, it is equally important to determine which exports Japan will seek to encourage, and which industries Japan will seek to protect. Which are Japan's vital interests?

To determine these parameters, it is necessary to do more than evaluate the current situation. It is also necessary to determine what effect changes in the export-import rate of each commodity might have on future costs and trade capability.

The answers to these questions and the careful delineation of the economic issues at stake in trade negotiations are in no sense sufficient to establish a negotiating position. Non-economic issues, not least of these domestic political considerations, will and should play a substantial part. But the definition of the economic issues is a necessary--and in our judgment currently neglected--part of the complex of considerations that must be taken into account in deciding our negotiating position in trade discussions with Japan.

DYNAMICS OF JAPANESE COMPETITION

INTRODUCTION

The assessment of Japan's ability to compete effectively in world markets, particularly in the U.S. market, has usually focused on Japan's lower wage rates, special export incentives, "dumping" practices, and controls on imports and foreign investment. Yet, paradoxically, Japan's competitiveness in a wide variety of products has increased as her wage rate differential with respect to the U.S. has narrowed sharply and as she has dismantled more and more of her incentives and protectionism. In addition, Japanese companies have been quite successful and profitable in both domestic and overseas operations.

During the 1920's, Japanese wage rates and per capita GNP were at about one-tenth of U.S. levels, but Japan's only significant export to the U.S. was raw silk, accounting for perhaps 80 percent of Japanese exports to the U.S. market. At present, Japanese labor rates are at West European levels, about one-third of comparable U.S. rates, and several economists are predicting wages and per capita GNP at or above U.S. levels by the 1980's. However, the diversity, technological sophistication, and effectiveness of Japanese competition has at the same time increased markedly and will continue to do so. Color TV, autos, steel, supertankers, and cameras bear little resemblance to raw silk.

It is apparent that Japan is committed to a gradual but firm course aimed at eliminating both her various special export incentives and the protection of most of her major industries from imports and foreign investment. By the mid-1970's, Japan could well be the least protectionist country in the world as well as the most competitive. Therefore, excessive attention to issues that are of declining real importance can only mask the actual underlying dynamics, with grave consequences of misperception for U.S. industry and the U.S. government. For this reason, it is imperative to clarify the cost effectiveness of Japan's high growth rates and the interaction of these growth rates with Japanese pricing behavior. The dynamics of Japanese competition are not being phased out; they will continue.

COST EFFECTIVENESS OF HIGH GROWTH

Experience Curve

It has been shown that for a variety of industries, total cost in constant dollars (or yen) will decline by a characteristic amount each time accumulated production experience doubles. This is true for entire industries as well as for individual companies and has been observed in many countries, including the U.S. and Japan. For most industries and products, the unit cost decline is about 20 to 30 percent for every doubling of accumulated experience. The cost-experience relationship can be plotted on log-log paper to give the industry (or company) experience curve (Exhibit 5).

The cost-experience effect is much more noticeable in new products than in older, more mature products, since the new products have a much smaller experience base, and a higher growth in demand. At first, the accumulated experience of these products can be doubled very rapidly, and costs will fall accordingly. In more mature industries, the effects of inflation may obscure the constant dollar decline in cost. To obtain an accurate picture of the experience curve, one must factor out the effect of inflation. (This should be done for new industries as well as mature ones in order to avoid any distortion of the curve.)

The distorting effect of inflation can be eliminated by measuring the current dollar unit costs deflated by the GNP deflator against the accumulated volume produced.* Given the historical experience curve characteristic of the industry, one can then predict future costs at various levels of accumulated experience. To estimate actual future dollar costs, it is necessary to reinflate the figures by multiplying constant dollar cost projections by the expected rate of inflation.

It is readily apparent that an individual firm's cost position within an industry will depend on its growth relative to that of the entire industry; that is, on its market share. And conversely, an industry's ability to lower costs for a given amount of production will depend on the market share of the individual producers: i.e., on the degree of concentration within the industry.

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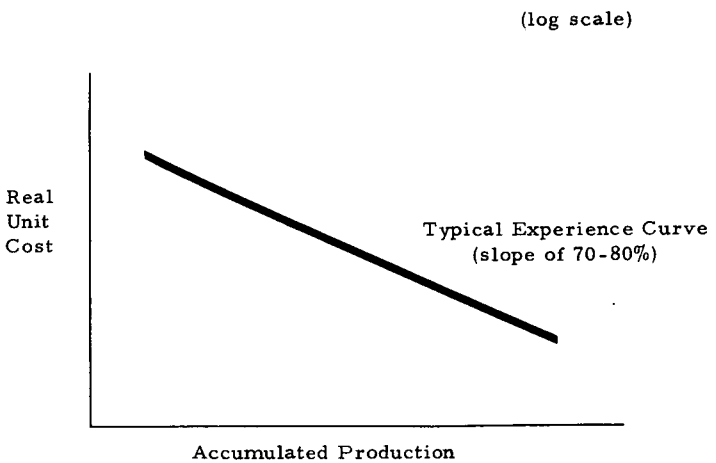
* Since cost data are not always available, it is often necessary to derive experience curves from price data on the assumption that costs will follow prices fairly closely over time.

EXHIBIT 5

SCHEMATIC EXPERIENCE CURVE



The experience curve effect is important because it enables one to calculate the change in relative costs of the U.S. and Japan for any g ven industry. These costs (past, present and future) are a function of:

- the initial production costs in Japan and the U.S.;
- the rate at which the U.S. and Japan are accumulating experience (this rate being dependent on when each began to produce the item and on the annual growth rates of the two countries);
- the amount by which costs decline in each country for every doubling of accumulated experience (i.e., the slope of the experience curve);
- the relative rates of inflation in the two countries (i.e., differences in GNP deflator); and
- their exchange rates.

Given the value of each of these factors, one can determine the relative and changing cost positions of the two countries--the U.S. and Japan--for a given industry. If Japan accumulates experience at a rate of 15 percent a year, it will double its accumulated experience in five years. If Japan's costs decline by 20 percent with every doubling of experience, a 15 percent accumulation rate will exactly offset a 4.5 percent rate of inflation. Thus, Japanese industries with accumulation rates above 15 percent and/or cost declines of 20 percent or better for every doubling of experience will have lower costs in current dollars in the future than at present if the Japanese inflation rate is four to five percent. These industries will therefore be able to lower the actual price of their products.

Given this situation, the U.S. can maintain its price competitiveness in a product it has introduced only if the following conditions are met:

- the initial production costs are lower in the U.S. than Japan;
- the U.S. is accumulating experience more rapidly than Japan;

- for each doubling of experience, U.S. costs decline by a greater percentage than Japanese costs;

- the U.S. has a lower inflation rate than Japan.

It is unlikely that all of these conditions will be met. The U.S. may well have higher initial production costs than Japan, because Japan can borrow or buy U.S. technology and profit from U.S. mistakes. Nevertheless, Japan's competitive advantage does depend on the availability of technology.

The U.S. may be accumulating experience as rapidly as Japan, depending on the capacity and production volume of the firms in each country's industry. However, since the U.S. was the initial producer, it is logical to assume that it will have a larger experience base and that it will consequently take longer to double its accumulated experience.

The degree of cost decline with each doubling of experience depends on such factors as unionism, industrial concentration and the educational level of the workers in the two countries. The decline is also influenced by the rate of technological change in the two countries and by the number of firms competing in the industry in each country. (In general, the fewer the number of firms, the steeper the industry experience curve, since the experience and cost benefit are not spread over as many producers.) In this respect also, Japan has an advantage in its company unions and in the more favorable attitude of its government toward antitrust and industrial concentration.

The final factor, inflation, is primarily a function of fiscal and monetary policies, but is also influenced by productivity differentials. And there can be no question that U.S. inflation levels, which since 1967 have approached Japanese levels, have played havoc with U.S. competitiveness; up until that time the three percent inflation differential between the U.S. and Japan roughly offset the cost reduction effects of Japan's higher manufacturing growth rate.

Each of these factors, however, can be influenced by the decisions of the nation's businessmen and government policy-makers. By controlling these factors, the U.S. can alter its international competitive position and the product cycle development of its industries.

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Product Cycles and Economic Development

A comparison of Japanese and U.S. industrial performance over time shows that the U.S. has not met the conditions necessary to maintain its competitive position in the industries it has developed or in which it has been a successful follower. Thus, Japan's movement down its experience curves has logically resulted in the product and industry evolution just described and will probably continue to do so.

Product and industry life cycles are of course a recognized and logical economic phenomenon. The scientific and material resources needed for the invention and commercialization of any new product are generally concentrated in a few advanced countries (most frequently in the United States). A wide range of innovations are stimulated by the conditions of domestic demand and supply which these countries enjoy:

- high wage rates promote labor-saving innovations;
- high personal incomes stimulate demand for new products;
- large military and space programs support technical innovations which may ultimately have consumer applications;
- the availability of large amounts of capital and skilled labor permit development to occur.

These demand-and-supply conditions do not occur in the less developed countries until their income levels begin to rise; therefore, the LDC's generally lag behind the advanced countries in the development of innovative products. The less developed countries do attain the required levels of demand and begin to make these products at the same time that demand for them is slowing in the advanced countries. This process results in intra- and inter-industry development within a country and in an industrial emphasis that moves continually from products that are less technically sophisticated and capital-intensive toward those which require more capital, more skill, and greater technological sophistication. This historical evolution is readily apparent in the Japanese case.

After being introduced in the U.S., new products and processes generally diffuse abroad, at first to other advanced countries, such as

Japan, which have the technical capabilities and resources to identify and imitate the required technology. The less developed countries generally adopt the innovations more slowly depending on the upward shift in their demand and technological supply structures.

This process is shown schematically in Exhibit 6 and proceeds as follows:

1. The U.S. invents and produces the product, then exports it to other advanced nations, e.g. Japan.

2. Japan imports, imitates, produces, and finally exports the product. At first, exports are generally sold to less developed countries and only subsequently to the U.S. market.

3. An LDC repeats the pattern, finally becoming an exporter to the less developed countries, then to advanced countries.

4. Eventually, the U.S. has fewer and fewer export markets, and finally its own market is penetrated by imports. At the same time, there is a decline in the contribution of this product or industry to the GNP and economic growth of the U.S.

5. The process continues for various follower countries according to changes in their development levels and the rate of product or industry obsolescence.

This process is well documented for many Japanese industries and products. Consider the cotton textile industry, where U.S. and European dominance gave way first to Japanese competition, and later to competitors from Hong Kong, Korea, and Taiwan. Today the cycle is entering a new phase, with India and Pakistan developing their own cotton textile industries. Wool and synthetics are following a similar evolutionary path (Exhibit 7).

These product or industry life cycles are continually evolving for all industries in each economy, with new industries emerging all the time. In each country, therefore, one finds a constantly changing spectrum of industries in various stages of development (initial development, growth, maturation, decline, export and import).

EXHIBIT 6

PRODUCT CYCLE

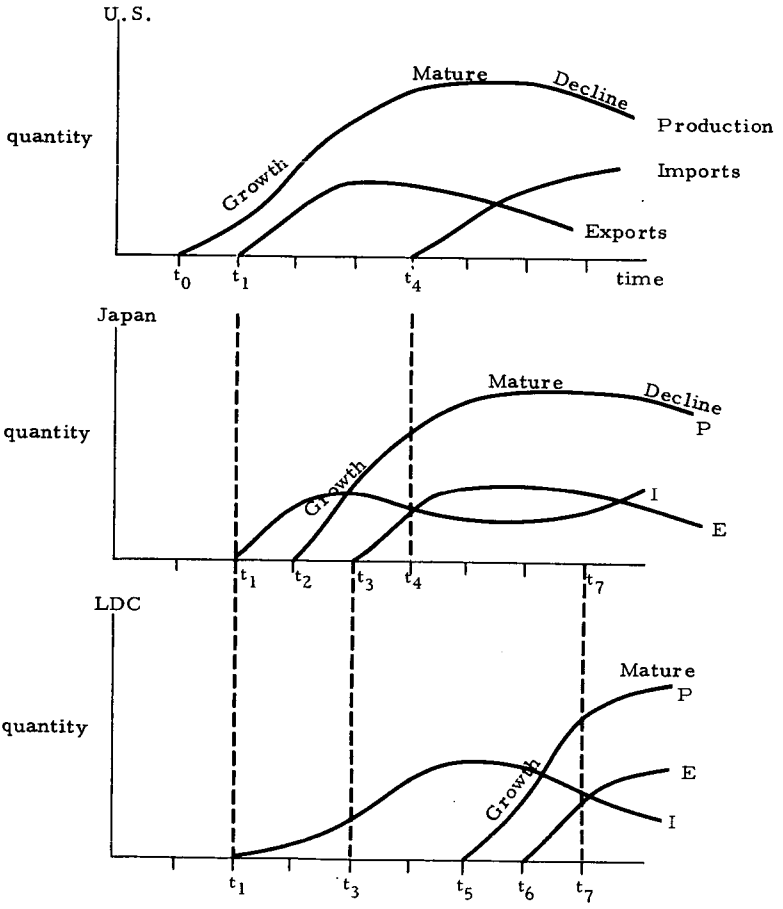


EXHIBIT 7

RECENT DIFFERENTIAL GROWTHS IN WORLD TEXTILES
AND ASSOCIATED HISTORICAL DECLINE IN U.K. TEXTILE INDUSTRY

Number Active In-Place Looms (1000's)

Year	Area:	North America	Europe	LDC's incl. Japan
1960		440	677	1289
1964		413	585	1590
1966		406	513	1651

U.K.*

Year	Labor Force (1000's)	Spindles (MM)	Looms (1000's)	Fabric Prod. (MM sq. yds.)	Fabric Exports (MM sq. yds.)
1910	710	40	790	8,500	6,800
1960	265	18	280	2,300	470
1968	125	4	95	1,500	230

* In 1968 40% of U.K. textile market was supplied by imports from LDC's.

Because this is an ongoing process, it is unreasonable to expect that a particular country, including the U.S., can continue to dominate any given industry forever. The underlying reasons for this are explained by comparative experience development. That the Japanese seem to understand this process better than we do, at least intuitively, is indicated by their willingness to phase out and rationalize declining industries, such as cotton textiles or sewing machines, in favor of newer high-growth products. In fact, it is these high-growth industries which the Japanese have protected and are continuing to protect by means of controls on imports and foreign investment. In this way, Japan consciously pursues a policy which constantly shifts the economic and industrial emphasis from low-growth, less sophisticated products toward high-growth, more sophisticated products--a very rational policy that has contributed substantially to Japan's postwar economic success. On the other hand, the U.S. policy--which, in direct contrast to Japan's, protects slow-growth, declining industries while leaving high-growth industries on their own--has been self-defeating in terms of resource allocation, growth, and meeting Japanese competition.

The Relationship between Experience and Product Cycles

Particularly when a product is new, the number of units needed to double the accumulated production experience is small as compared with annual production. Later on, however, this number increases so that over time, cost declines become smaller both relatively and absolutely.

In the early years of production of a commodity, the U.S. accumulates experience at a rate substantially above the rate of growth in market demand. A 15 percent growth rate in demand might mean a 25 or 30 percent accumulation rate and a correspondingly larger drop in costs. At the same time, increases in productivity and declining relative prices are large.

As U.S. domestic demand levels off, however, both the industry growth rate and the accumulation rate decrease, the latter relatively faster, so that price declines slow both relatively and absolutely. During this second phase, an industry shakeout usually occurs as one or two firms lower prices in order to gain market share. After the shakeout, when market shares stabilize, the dominant producer's experience curve essentially becomes the industry curve, the industry curve being the net effect of the experience phenomenon for all the industry's firms.

At this point international competitive strategy becomes important. If the innovating country fails to capture the increase in world demand

(either because of international trade barriers or its own strategic errors), it will lose world market share to competitors in follower countries like Japan who will begin production and proceed down their own experience curves.

Initial production costs are usually lower in Japan than they were in the U.S., and cost declines may also be steeper since Japan can quickly take advantage of technological transfer possibilities. The U.S. has even facilitated this process by licensing and patent agreements.

Japan's initial costs, however, are usually higher than current costs in the U.S. despite the fact that they may be below the initial costs in the U.S. The exact difference in current costs will generally depend on the industry's capital intensity and technical sophistication (Exhibit 8).

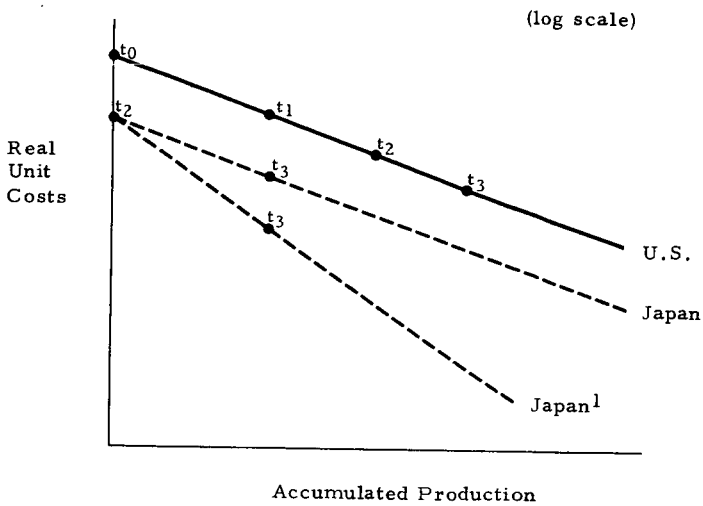
To catch up, Japan must then accumulate experience at a rate which is faster than the current U.S. rate, but it need not acquire more (or even as much) experience as the U.S. in order to approach the latter's cost position. Reduction in relative costs proceeds fastest during Japan's initial production stages because the accumulation rate is higher at this stage of industry development for any given growth rate. In addition, during this initial period of production, Japan may enjoy greater growth in demand and production than the U.S. if the U.S. market is becoming mature. However, it is only after this initial period of rapid cost reduction that Japan becomes competitive enough to export. This explains why in Japan, unlike the U.S., it is only <u>after</u> the period of highest productivity that an industry enters a period of rapid export growth.

Japan may also benefit from a steeper experience curve attributable to technology transfer, to a high education level relative to the country's economic development, and/or to lack of opposition to innovation on the part of labor. Studies done by The Boston Consulting Group, however, indicate that Japan's cost slopes approximate those of the U.S. for similar products.

Given a similar growth in demand in both countries, the ability to sustain a high growth rate (and, therefore, a high accumulation rate) is a function of the availability of capital to expand capacity. This in turn is a function of retained earnings, use of debt, and tax rates. Thus, an individual corporation's ability to increase its domestic and international market share depends on its own financial policies and its country's financial environment. More specifically, the large use of debt by Japanese companies facilitates higher growth rates and lower margins

EXHIBIT 8

EXPERIENCE AND COMPETITIVE CHANGE



for the same return on equity. This policy, combined with a higher breakeven due to fixed labor costs and high fixed capital charges, tends to stimulate penetration pricing and continuous operation at full capacity. The section on Japan's approach to pricing which follows will discuss more completely the Japanese policy of dropping prices continuously as costs move down the experience curve.

In addition, Japan usually benefits from the economic conditions present in the U.S. In general the U.S. has higher wage rates and higher prices than Japan. As growth slows, productivity increases also slow so that higher wages are not offset to the same degree that they were in earlier stages of industry development. At the same time, as the U.S. industry begins to mature, its domestic market becomes increasingly price sensitive and vulnerable to low-priced imports. In spite of U.S. protectionist policies, these economic forces constantly push U.S. industry toward the development of newer and more sophisticated products, with Japan following behind.

The successful Japanese follower will usually increase his export market share first in less developed countries, where there is no domestic competition, where demand is growing, and where the U.S. has no innate advantage.

These exports serve multiple competitive functions. They impair the ability of the U.S. to accumulate experience and lower costs relative to Japan. At the same time, they enhance Japan's ability to accumulate experience and to lower costs. Competitively, there is a double experience-cost effect. This can be very important if the Japanese domestic market is relatively small and is quickly saturated, or if costs must be lowered further to stimulate additional domestic demand. Furthermore, these exports develop Japan's overseas marketing experience.

These developments are critical if Japan is to gain enough strength to penetrate the U.S. market. This task is difficult because U.S. market demand is growing more slowly, in-place capacity is difficult to dislodge, and domestic competition exists. However, quotas and high tariffs are seldom applied by the U.S. until after significant market penetration, when the U.S. industry is already in an obvious state of decline.

Therefore, in spite of the difficulties encountered, Japan usually penetrates the U.S. market and local producers go into a state of decline on their home ground, becoming even more subject to the competitive

pressures which result from loss of market share and deterioration of relative cost position.

The repetition of this process in other countries (LDC's) is limited only by the rate of product obsolescence which may prevent such followers from catching up.

The product cycle is thus seen as reflecting the diffusion of technology from one country to another and the impact of comparative accumulations of experience in different economic environments. It also reflects the fact that a firm's ability to gain market share in the early stages of an industry's growth enables it to lower costs faster than its competitors, and thus increase its market share still more.

This process, if properly funded, results in a high growth rate and a dominant market position. Gradually the firm's growth rate settles down to that of the market as a whole and the market becomes mature. Any increase in the dominant firm's market share will reduce its costs and ultimately force industry prices down, making the industry curve steeper. The continuing evolution of this process is limited only by a 100 percent monopoly situation.

For Japan (the follower country) to enter the cycle, it must capture that portion of growth in world demand represented by the growth in its own domestic demand. This is generally made possible by the protective policies of the Japanese government, by changes in U.S. (the innovator) financial strategies, or by the domestically restricted market perception of U.S. companies.

That is, once the U.S. domestic market matures, the manufacturer may decide to forego continued high growth (which requires continued heavy investment and aggressive pricing) and attempt, instead, to earn a return on his past investment by maintaining a constant price level. Moreover, he may decide that the size of the foreign market and the threat of foreign producers, particularly Japan, are not yet great enough to justify a fight against the foreign government's protective policies, though this way of thinking may be changing.

Since demand in many industries is still growing in Japan, her internal growth rates and growth in world market share is quite rapid relative to the U.S. As Japanese industries gain experience and benefit from the process outlined above, they begin to export to the less developed

countries and subsequently to advanced countries, especially the U.S., whose markets are as yet unprotected and where antitrust policies prevent rationalization. As a result, Japanese industries continue to increase their world market share, generally at the expense of U.S. industry. This situation allows them to further improve their cost position relative to their U.S. competitors.

This process will continue until other countries enter the cycle and begin to exert the same sort of competitive pressure on Japan. This has already happened in the textile industry, for example. At the same time, however, Japan will have begun the "following" process in some newer industry, accelerating the catch-up cycle by means of high debt leveraging and consolidation. This is typical of Japanese firms. Their comparative competitive success as followers will, however, depend on their industry's relative growth rate, Japan's inflation rate, and their experience cost curves. These in turn will be determined by their firm's investment, marketing, pricing, and financial strategies as well as by the general economic and political environment in Japan and the U.S.

There are several sensitive points within this evolutionary process, for each country and for each firm. These include initial production, initial export development, and initial penetration of the U.S. market. At these points, key variables such as margins can be effectively influenced by external pressures. The ability to apply or resist such pressure is in turn closely related to:

- a firm's investment strategies (foreign and domestic);
- its marketing strategies (including exports);
- its pricing strategies (domestic and foreign); and
- its financial strategies.

In addition, it is related to the country's current position in the product cycle and its likely position five or ten years hence.

POLICY IMPLICATIONS

The above analysis has immediate and profound implications for U.S. policy vis-a-vis Japan. Until now, Japan has quite rationally protected her growth industries from foreign (U.S.) exports which would keep her industry from developing, and from foreign (U.S.) investment which would merely serve the Japanese domestic market and would not develop into a major export industry. Japan has been able to adhere to this policy in part because the U.S., in its trade negotiations, has been preoccupied with protecting its declining industries (e.g., shoes and textiles) rather than its established or growth industries. In addition, U.S. antitrust policies--which have prevented various industries from combining into more competitive economic units better able to accumulate experience--have only exacerbated the unfavorable competitive situation.

The Japanese have also shown a better intuitive understanding of the economic forces at work in their competitive development. This is apparent in many policy statements by Japanese business and government officials. The U.S., on the other hand, has failed to respond with any integrated trade strategy, or basic understanding of the competitive process, and has instead continued to react on the basis of ad hoc political pressures. These pressures have naturally favored declining industries rather than growth industries, where we tend to be over-confident.

Furthermore, Japanese financial strategies, incorporating high debt and high breakeven characteristics, have helped create a finely-tuned growth system--a system which, even given the same initial costs as in the U.S., normally sets lower prices and ultimately achieves lower costs and still lower prices. This is particularly true in export markets where trading companies offer a more efficient distribution system than the one existing in Japan itself. Given this competitive challenge, the U.S. can only respond effectively by thinking its way through some necessary changes in its present business practices and government economic policies.

More specifically, the U.S. has tended to give away experience by investing overseas rather than exporting. This is a second-best solution to the problem of access to foreign markets from the point of view of U.S. costs and contribution to GNP. In some cases, overseas investment is indeed the only way to gain or maintain access to foreign markets, but in general it seems that U.S. firms simply prefer to invest overseas rather than export. This is probably a logical preference; its large volume of

exports to the contrary, the U.S. is not really structured for export. The U.S. export distribution system is fragmented and expensive, and there have been legal restrictions on the integration of functions which might otherwise have served to reduce costs. In addition, U.S. antitrust laws deter cooperation by U.S. firms in export marketing and in the creation of joint or cooperative trading companies which would spread overseas marketing costs over several products. For example, what would the U.S. government do if Ford and GM cooperated to defeat Toyota competitively overseas? Some relief from antitrust is required in this area if the U.S. is to meet Japanese competition, which concentrates experience in Japan and invests overseas only in raw materials or declining industries.

The domestic antitrust policies of the U.S. also erode the experience base for export and accelerate the decline of maturing industries by preventing concentration of experience in one or two producers. The U.S. currently tends to think of competition only in domestic terms; it needs to extend its view to worldwide competition. Such a change in viewpoint would lead to more efficient U.S. production units, a more competitive position, and lower consumer prices, and would coincide with our traditional free trade posture as well, since imports would be freed.

Such a change in outlook implies a reversal of traditional U.S. policy--from protecting only declining industries, as is done now, to protecting only those industries whose growth rate is faster than that of the GNP or of industry as a whole. That is, the U.S. needs to be more conscious of the benefits to be derived from the huge U.S. domestic market, from U.S. R&D capability, and from high growth. The U.S. market is twice the size of Japan's and will remain so, even if per capita purchasing power becomes the same. This means that the experience base and the potential cost advantage of the U.S. will always be larger than Japan's if equivalent industry concentration exists in the two countries. By protecting this base, the U.S. should be able to remain competitive if it exports effectively, capturing world market growth.

Conversely, it is essential for Japan to have access to this huge U.S. market if she is to maintain cost advantage and continue to grow after her own market becomes saturated. Her alternative overseas markets are limited, at least in the near future. These markets are growing fast but they cannot provide the quantitative amount of growth required to add to Japan's increasingly larger experience base at a rate which will continue to lower costs significantly. However, effective penetration of the U.S. market, the largest and most developed in the world, can provide significant additions to Japan's experience base. Although Japan is

gaining a greater position in Western Europe; although Southeast Asia will remain important for initial export development; and although some specialization agreement with China might be worked out, the U.S. will remain Japan's major foreign market for the foreseeable future.

One must therefore conclude that a rational negotiating posture for the United States would be to force Japan to pay for access to certain U.S. markets with access to certain of their own markets (e.g. their access to the U.S. auto market in exchange for U.S. access to the Japanese computer market). This policy would naturally force a decision as to who would specialize in which products, since Japan's ability to develop an industry depends on protection, and her ability to sustain cost advantage depends on access to overseas markets, particularly the U.S. market. Consequently the U.S. must move to stop Japan's progress in a given industry while it still has a cost advantage. Protection is of little use in an already declining or slow-growth industry. Conversely, in those areas in which the U.S. is following Japan (e.g., video cassettes and reproduction) it could use protection of high-growth industries to even greater advantage than does Japan, given the fact that the size of the U.S. market permits much faster accumulation of experience.

JAPANESE PRICING: "DUMPING" OR SOUND STRATEGY?

The cost consequences of Japan's rapid growth have been discussed thus far in terms of the economy as a whole, and of industry or product groupings. Turning now to the individual firm, the question can be asked, how do these cost effects translate into pricing behavior? Why is it that Japanese firms are so often seen as pricing in "unfair," "irrational," "uneconomic" ways? Japanese companies are commonly accused of "dumping" into world markets. Yet it is clear that if Japanese companies were in fact persistently dumping (whatever that may be taken to mean), they could hardly continue to exist for long periods, much less finance their very rapid and continued growth. Is there then a basis for analyzing Japanese pricing behavior which, taken with the effects of rapid growth, demonstrates a real competitive advantage? We believe there is.

The Price Implications of Corporate Debt

To get at the issue of Japanese pricing behavior, one must first note an aspect of Japanese corporate practice which is strikingly different

from that of the West. As Exhibit 9 suggests, Japanese companies characteristically depend very heavily on debt as a source of corporate financing. Indeed, the typical level of debt financing is so high as to suggest to Western businessmen that the average Japanese firm is virtually bankrupt. For the typical Japanese firm, less than 20 percent of total capital employed is owned capital (equity and retained earnings) with more than 80 percent of total capital employed being made up of short and long term borrowings and the financing of trade receivables. U.S. companies characteristically source most of their capital from equity and retained earnings, while debt comprises a third or less of total capital.

The effects on pricing behavior of this very great difference in financial practice are startling, as suggested in Exhibit 10. Assume two companies, a U.S. company and a Japanese company, competing with each other. Assume that their costs are roughly equal, but that the Japanese company follows Japanese financial practices, and that the American company uses somewhat more debt than is customary in the U.S. If both provide their shareholders an equal return (10 percent on equity) and grow on a sustained basis at ten percent annually, the margin of the Japanese company will be roughly half that of the U.S. company. Therefore, given equal costs for the two companies, the Japanese company can service its debt, pay an equal return to shareholders on their portion of total capital, and yet maintain a growth rate equal to that of the U.S. company at a far lower price level.

While Exhibit 10 is a generalized example, companies in the two economies do in fact display the effects of these differing approaches to corporate finance. The Bank of Japan reported 1968 results for major companies in both economies; Japanese companies were far less profitable in terms of after-tax return on sales (2.6 percent compared to 5.1 percent for the U.S. companies) but provided a higher return to shareholders (13.7 percent compared to 11.8 percent).

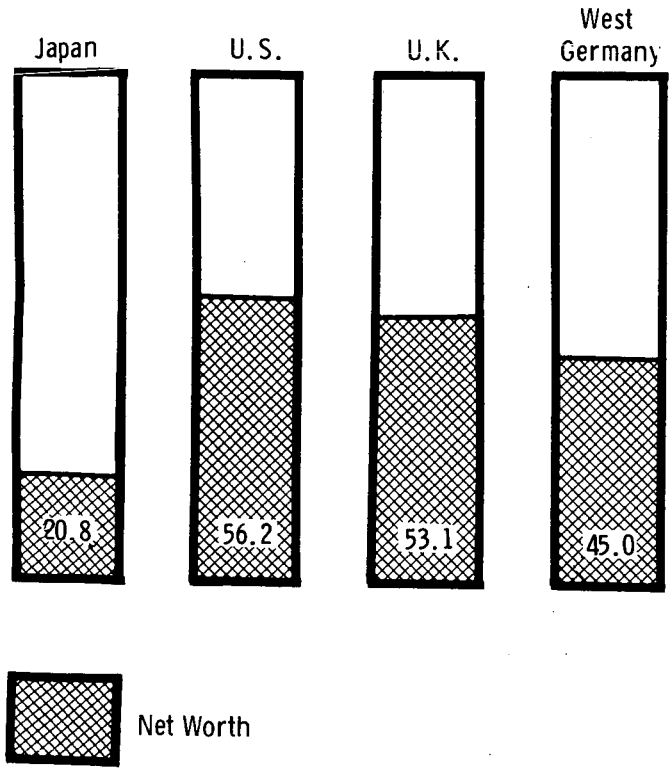
Thus the generous use of debt by Japanese firms in effect uncouples their growth rate from their profitability as long as they are able to cover their debt service and dividend payout. This practice permits the continued financing of rapid growth even though sales are made at significantly lower margins.

But if the high use of debt confers so substantial a competitive advantage, why do U.S. companies not follow a similar strategy? A full answer is both complex and outside the present discussion. Briefly,

EXHIBIT 9

CAPITAL STRUCTURE

(1968)



Source: Bank of Japan

EXHIBIT 10

MARGINS REQUIRED TO GROW AT 10%

	Japan	U.S.
Assets	100	100
Debt	80	40
Equity	20	60
Sales	100	100
Profit		
Before Interest and Tax	14.4	27.2
Interest	6.4	3.2
Profit Before Tax	8.0	24.0
Profit After Tax	4.0	12.0
Dividend	2.0	6.0
Return on Equity	10.0	10.0
Reinvestment of Earnings	2.0	6.0
Additional Debt	8.0	4.0
Growth Rate	10%	10%

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however, it can be said that Japan's business environment reduces the risk and makes tolerable for large Japanese companies a debt level that would in fact be unattainable and intolerably risky in the U.S. environment. The financial risks associated with high debt levels are very much reduced in Japan by the fact that the central bank stands implicit guarantor of the debt position of major Japanese companies. No American company can assume a similar support from the Federal Reserve System. Further, an American company is constantly vulnerable to the threat of prolonged strikes which can make enormous demands on liquidity. The thin cash position of Japanese companies would make prolonged strikes devastating, but Japanese labor relations and personnel practices make such labor conflicts unlikely.

In looking at Japanese price behavior, then, one must first appreciate that the Japanese business system permits an extraordinary level of debt financing for corporate growth, and that this sourcing of capital in turn makes it possible for a company to operate at significantly lower margins than is possible in the United States.

The Full Capacity Policy

One consequence of this financial policy however is the great financial pressure on the Japanese company which results from the obligation to service its high debt level. Sizeable interest charges contribute to a generally high level of fixed costs for a Japanese company compared with a U.S. company. This fact too has direct implications for Japanese pricing behavior.

To take a specific, and currently controversial, product, Exhibit 11 compares cost levels for Japan and the United States in nylon production. The Japanese advantage in labor costs is somewhat offset by higher overhead costs and by interest charges. Total costs are similar. However, owing to the nature of personnel relations in the large Japanese company, with employees essentially hired for their entire careers, all labor costs as well as sales, overhead, and interest costs, are in fact fixed for the Japanese company. For the American firm, labor is largely if not entirely a variable cost (this analysis assumes that about one-third of U.S. labor costs are effectively fixed). Taken with lower overheads and little if any debt service, a much smaller proportion of the U.S. firm's total costs are fixed.

EXHIBIT 11

COST COMPARISON, U.S. AND JAPAN:
NYLON PRODUCTION

	Japan, Inc.	U. S. Competitor
Materials	20	22
Labor	10	15
Sales and Administration	20	20
Overhead	15	13
Debt Service	2	0
Total Cost	67	70
Fixed Cost to Total Cost*	70%	54%

* Assuming all Japanese labor cost fixed and 1/3 U.S. labor cost fixed,

$$\text{Japan} = \left(\frac{10 + 20 + 15 + 2}{67}\right); \quad \text{U.S.} = \left(\frac{5 + 20 + 13}{70}\right)$$

The high fixed costs of a typical Japanese company result in what might be called a "full-capacity policy." That is, since most costs are fixed, there is considerable incentive for the Japanese firm to operate at full capacity so long as the product can be sold at prices that are somewhat above variable costs--in fact, somewhat above the cost of raw materials. Since the breakeven point is high and cannot be significantly reduced in the short run, management is constantly pressed to lower prices as necessary to ensure continued full operations as long as these prices do not drop below variable costs. In the U.S. case, this price point is reached much sooner than in the Japanese case, since a substantially larger share of U.S. costs are variable and can be reduced.

Taken together with Japanese financial practices, this "full-capacity policy" means that the Japanese firm is able to price lower while maintaining required levels of return and a high growth rate, and has a powerful incentive to price lower in order to maintain full capacity.

Pricing Implications of Rapid Growth

These facts about Japanese companies must be seen in the context of very rapid economic growth. The implications of Japan's high growth rates have been analyzed in the larger national context, but rapid growth impacts on the pricing behavior of individual companies as well. In many ways the experience of the current generation of Japanese businessmen is unique. They have known twenty years of uninterrupted growth, and for nearly all of this time have known growth at rates virtually unprecedented in history. Further, they have a government that is committed to continued rapid growth, and the credibility of that commitment is strongly reinforced by their successful experience. Indeed, their government's generous estimates of growth have nearly always fallen short of realized rates of economic expansion.

This strong sense of confidence that demand will increase at a rapid rate, and their long experience with rapidly expanding markets, has confirmed the necessity to invest in anticipation of demand. In a national economic sense, this makes for a self-fulfilling prophecy--the investment in anticipation of demand creates the economic conditions that bring about the increased demand. For the individual company, it means that since capacity does not increase smoothly but rather expands in large periodic increments, there will be periods of temporary excess capacity. And it is evident that Japanese management is likely to clear that capacity at

temporarily lowered prices, and into world markets. This fact, in conjunction with the typical approach to export marketing discussed below, helps explain a part of Japanese pricing behavior that Japan's competitors object to and often find inexplicable.

But from the point of view of the Japanese company, the preoccupation with investment and market share in the domestic market is entirely reasonable. At Japanese growth rates, failure to maintain market share can very quickly lead to a disastrous competitive position. Japanese industrial output has been growing in real terms at some 13-14 percent per year. This means that in the modern sector most industries are doubling in size every five years or less. Put another way, if a competitor enters a market from a zero position and simply takes the growth of the market without reducing the sales volume of other companies in the field, he will hold half the market in only five years. Given the experience curve effect, the cost implications of this kind of market share loss are clear. The same phenomenon would of course occur in the United States, but since U.S. growth rates are generally much lower, management's appreciation of the effects of market share loss is much less. In the Japanese context, however, it is entirely appropriate that management accept market share as a primary objective even at the expense of short term profitability.

Some additional special characteristics of the Japanese business environment reinforce this attention to market share. As Japanese industry swings away from labor-intensive toward capital-intensive industries, the effects of scale on cost are increasingly clear. Further, in the Japanese context, growth and thus market share have a direct effect on labor costs. Since employees are hired directly from school for their entire careers, and since their pay is essentially a direct function of their age, the average labor cost for a Japanese company is directly related to the average age of the work force. A rapidly growing company is hiring large numbers of young people; as the average age of the work force drops, labor costs also drop. Conversely, a slow-growing company in Japan has a work force that is aging steadily, and its labor costs are steadily rising. The payoff for growth then is immediate and clear.

Japanese Pricing and the Experience Curve Effect

All of these factors come together to create a business system in which rapid growth in demand stimulates rapid investment; rapid investment and thus maintained or increased market share translates directly into visible cost advantage; high fixed costs ensure that the additional

capacity will be fully utilized; and financial and competitive practices are such that margins in excess of the financial requirements for growth penalize firms in high-growth businesses. Under these conditions, it is hardly surprising that price becomes the primary competitive weapon of the Japanese company. The U.S. firm characteristically prefers to compete through increased services, additional merchandising or product differentiation, and uses price competition frequently as a last resort. And U.S. laws, notably the Robinson-Patman Act and ultimately the anti-trust laws, reinforce this tendency and place sharp limits on the use of price as a competitive weapon. The results in terms of international competition are unfortunate.

It will be evident from this discussion of pricing behavior that the Japanese firm is under considerable pressure to translate into immediate price reduction the cost improvements resulting from rapid growth. The common phenomenon in the U.S. of a "price umbrella" being held over the market by the leading producer for an extended period is far less commonplace in Japan. It would appear that the risk of loss of market share is too evident and too urgent. Thus Japanese prices tend to follow costs directly down the experience curve. This phenomenon, together with rapid growth, makes Japanese goods increasingly price competitive in world markets quite apart from other aspects of Japanese price behavior already noted.

What Are Real Prices?

This discussion of pricing behavior has so far dealt only with the individual producer, and with some of the factors that make for differences in pricing practices between manufacturers in Japan and the United States. The issue is made more complex, however, by differences in distribution methods and their effect on pricing behavior.

In Japan the traditional, and still general, approach to distribution both in the domestic market and for export has been the transfer of goods to a trading company, rather than the direct management of sales activities by the Japanese manufacturer. The Japanese trading company is unique to Japan. The large ones are very large indeed, with sales over $10 billion annually, and with worldwide office networks, dealing in virtually all kinds of goods. In terms of pricing behavior, the trading company is basically interested in rapid turnover, and in handling large volumes at relatively low margins. In contrast to a manufacturer who is selling for his own

account, the trading company has less interest in market stability and permanence. The pricing effects in world markets are obvious.

At the same time it must be noted that the trading company is in many respects a highly efficient vehicle for export distribution. Especially for a producer whose export sales would be below the threshold volume that would make an export effort economic, the trading company offers an efficient and inexpensive way of arranging transport, establishing inventory and reaching customers. The result is worldwide export market access for Japanese companies of relatively small size, for products whose export market potential is still limited, and to countries whose market is small. It seems likely that the lack of a comparable business institution hampers the U.S. export effort of those many U.S. companies that cannot economically justify entry to export markets, much less to markets of limited size.

The apparent efficiency of the trading company as a distribution mechanism for exports raises a difficult question, however, regarding the issue of "double pricing." It is commonly argued that Japanese companies are prone to "double price," with a higher price for their domestic market than for export markets. The real possibility of this kind of double pricing has been noted above in the discussion of the full capacity policy. It must also be noted however that distribution costs in Japan are high: distribution channels are multilayered with compounding margins; customers are numerous and small and thus expensive to reach; and payment terms are extended and difficult to enforce. Under these very different conditions of domestic versus export sales, it is clear that some caution must be exercised before bringing charges of "double pricing" against the Japanese manufacturer.

Some Implications for Policy

It is not easy to discuss this critical area of pricing behavior without running the risk of seeming to justify the Japanese approach. U.S. producers are in fact at some inherent competitive disadvantage. Japanese companies with costs similar to Western producers can price lower while being as profitable to their shareholders and financing faster growth--which in turn leads to lower costs, and under Japanese conditions this is promptly translated into still lower prices. This advantage, unless adjusted for by a higher rate of inflation in Japan than in the United States, must in fairly short time be balanced by a change in the exchange rate. The

alternative--that U.S. companies might adopt Japanese financial practices--is not available given government-business relations in the U.S.

This does not rule out however a more critical review by U.S. firms of their own export pricing policies. It would seem appropriate that roughly as many "dumping" charges should be brought against U.S. firms as are registered by U.S. firms against foreign competition. The current disproportion suggests that U.S. companies are not as aggressive as their foreign competitors in pricing to international markets.

The "dumping" issue also suggests that a change in response by the United States might be useful. By definition, the charge of dumping means that Japanese domestic prices are high and that a price umbrella is being held over the domestic market by Japanese producers, thus providing a cash flow to finance further product expansion. At present, the U.S. response to this situation is to close or limit access to the U.S. market. Strategically, an interesting alternative would be to trade off closure of the U.S. market against wide-open access to the Japanese market. If Japanese prices are in fact disproportionately high, U.S. producers should be able to penetrate that market and thus shut off the cash source that is financing further Japanese growth.

It would also seem useful for the United States to examine the trading company phenomenon. It is quite clear that most large American companies are entirely prepared to handle their own export sales (although even these might find a joint export effort to smaller overseas markets economic). But it is also clear that many of the smaller, specialized producers that only our huge economy makes possible have export markets that their scale and experience prevents them from penetrating. Are there perhaps, in the Japanese trading company, some of the elements that might be put together to expand the U.S. export effort and make U.S. producers better able to compete with the Japanese even outside the United States?

JAPANESE PASSENGER CAR PRODUCTION: A CASE STUDY

The following simplified analysis will illustrate how experience curve techniques can be used on specific products to analyze past and projected future developments in comparative advantage and product life cycle evolution between Japan and the U.S. The effect of policy variables can be examined by an extension of the same approach. The auto industry has been chosen to serve as an example since it is both important and topical.

The competitive strength of Japan's auto industry is now admitted by its U.S. counterpart. This recognition came very late, however, although all the signals described above were quite apparent. Whether this belated awareness was due to overconfidence, U.S. market myopia, or an absorption in the conventional mythology about Japan is not clear. It would seem, though, that the U.S. auto industry did not understand the dynamics of Japan's competitive development.

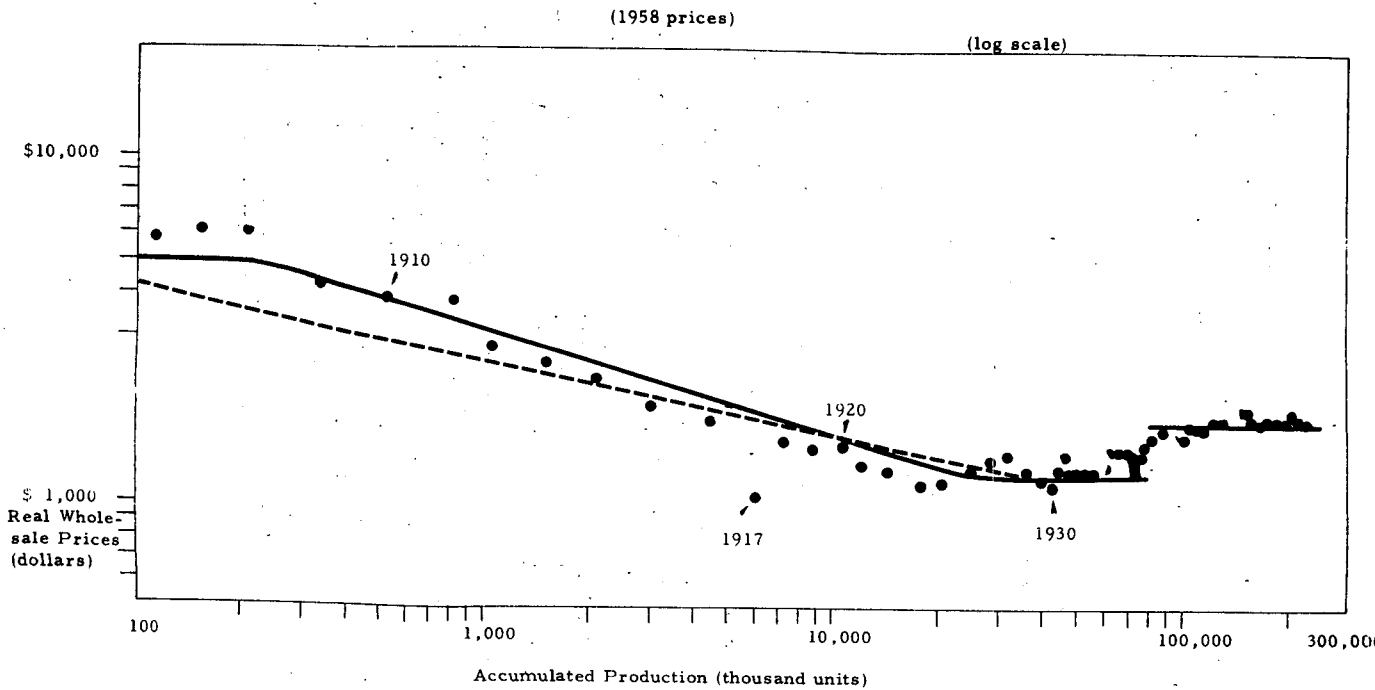
The U.S. began passenger car production at the turn of the century, but annual production was still only about 4,000 vehicles in 1900. Initial costs were high--around $5,000 in 1958 prices. Although production and accumulated experience grew quickly, with some drop in prices between 1900 and 1904, the real industry shakeout did not begin until 1908. After that time, there was a fairly uniform decline in real (and current) prices until 1930, reflecting the market dominance of Ford and the Model T. Accumulated experience doubled about every two years until 1916. Between 1916 and 1939, doubling occurred within three, four and five year periods successively.

The Depression and later World War II caused a stagnation in production growth, and there were only two further accumulation doublings between 1929 and 1960. The first took 13 years and the second 17 years. Possible price declines were thus quite limited. By the 1930's General Motors had emerged as the dominant producer and continued to dominate after World War II. Government monopoly policies, however, effectively restricted GM from reducing prices to further increase market share, but this did not prevent marginal producers such as Studebaker or Packard from being forced out of the auto business. Also during the postwar period, the larger car emerged as the representative model in the U.S. auto market. This explains the higher price umbrella (horizontal line) during this period as compared with the 1930's (see Exhibit 12).

Japanese passenger car production, on the other hand, was not at all significant until the postwar period, although a few cars were produced as early as 1935. Most of Japan's vehicle production was instead concentrated in heavy trucks and busses, small three-wheel trucks, and motorcycles. By 1952, only about 16,000 passenger cars had been produced in Japan. Average current wholesale prices at that time were about $2,900 as compared with $1,500 for a larger U.S. car. As Japanese wholesale prices include a sizeable excise tax levied at the factory, the difference between actual factory costs was probably somewhat less than $1,400 despite the U.S. domestic price umbrella and higher U.S. margins. In any case, real initial costs and prices for Japanese autos

EXHIBIT 12

U.S. PASSENGER CAR PRODUCTION
PRICE-EXPERIENCE EFFECT - 1900-1969



were well below original U.S. costs for the same amount of accumulated experience ($2,900 vs. $5,000).

The Japanese auto industry then proceeded down its experience curve with a slope similar to (but not steeper than) the U.S. curve at a similar stage of industry and product development. It also doubled accumulated experience about every two years and reduced real (and current) prices sharply. Therefore, despite a 36.8 percent differential rate of inflation between Japan and the U.S.* during the 1952-1969 period, the Japanese were able to lower current wholesale prices to roughly $1,700 per car as compared with $2,200 in the U.S. (See Exhibits 13 and 14.) At the same time, Toyota and Nissan emerged as the dominant Japanese producers, although the industry shakeout is not yet complete in spite of government-encouraged mergers.

The competitive interaction between the U.S. and Japanese auto industries clearly reflects their respective price-experience developments. In 1952, current wholesale prices were widely different ($2,900 for Japan versus $1,500 for the U.S.) and there was little or no export from Japan. By 1958-1960, however, the gap had closed to roughly $1,900 for the U.S. and $2,100 for Japan. Nissan was now exporting some 11,000 vehicles (mostly light four-wheel trucks) and Toyota 5,500 vehicles. Still, 86 percent of Nissan's and 84 percent of Toyota's exports were going to LDC's, mostly in Southeast Asia and Latin America.

In 1961, current wholesale prices for the two countries were comparable ($1,900 for Japan and $1,850 for the U.S.) although the American cars were of better quality and greater size. By 1964, however, Japanese current wholesale prices were below U.S. prices ($1,750 versus $1,900), and Toyota's and Nissan's cars were appearing in the U.S., although imports were only 2,000 and 10,000 units respectively in that year. Most of Japan's exports were still to LDC's (91 percent for Toyota and 85 percent for Nissan). By 1969, the price gap was substantial ($1,760 for Japan versus $2,270 for the U.S.) and Japanese exports to the U.S. had become significant. In that year Toyota sold 130,000 units and Nissan 87,000 units in the U.S., and a dealer network was established. At that point, Japan's share of the U.S. passenger car import market was nine percent and still growing. The competitive price differential had obviously increased to such an extent that size,

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* The differential rate of inflation is found by subtracting the U.S. rate of inflation from the Japanese rate of inflation.

EXHIBIT 13

JAPANESE PASSENGER CAR PRODUCTION
PRICE-EXPERIENCE EFFECT - 1952-1969

(1958 prices)

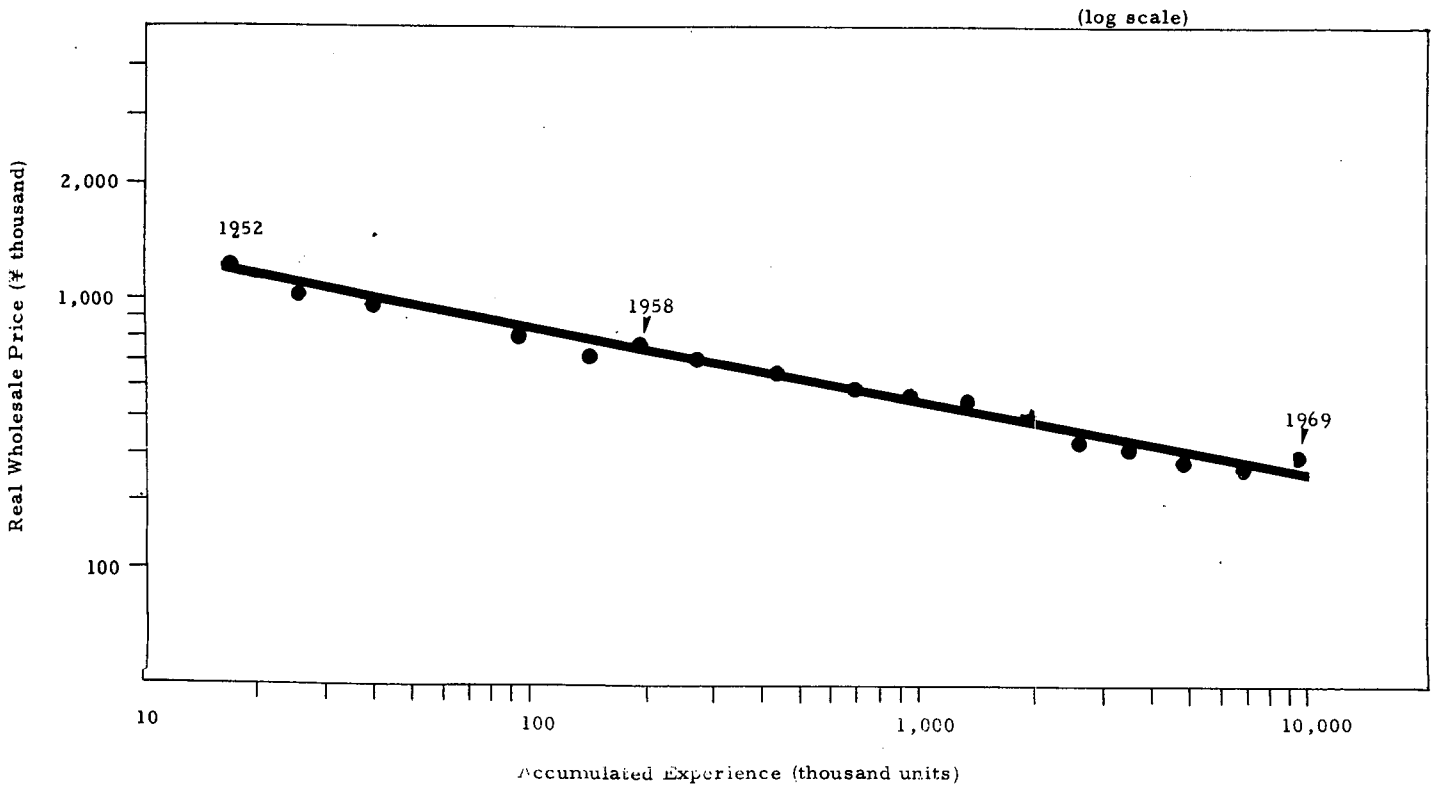
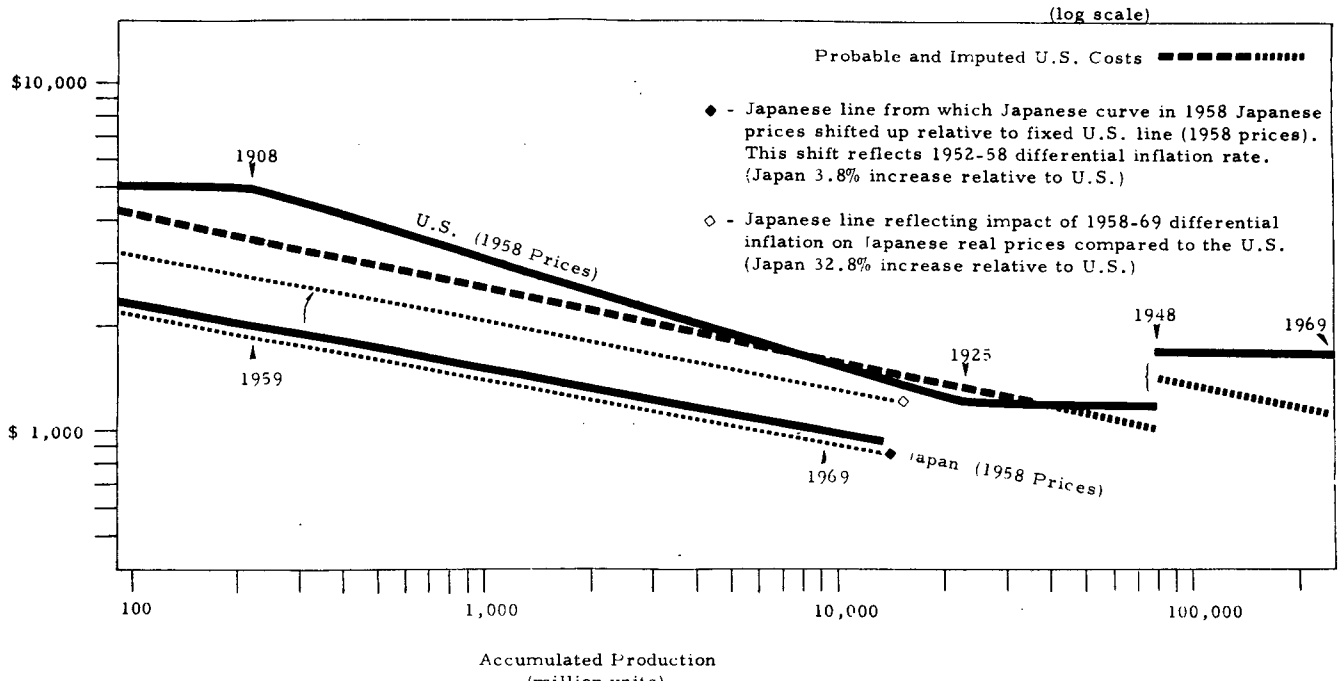


EXHIBIT 14

JAPANESE AND U.S. PASSENGER CAR PRODUCTION
COMPARATIVE EXPERIENCE DIAGRAM



service, and other considerations had been offset. And the Japanese strategy of producing and marketing the "fully equipped" car was quite successful. A "pocket-conscious" U.S. public also helped offset the effect of declining economic conditions on the overall demand for autos.

Following the usual pattern, exports and the U.S. market were providing the additional demand stimulus required to further accelerate a lowering of costs in the Japanese industry. As can be seen in Exhibit 15, passenger car exports grew from 11.6 percent of production in 1964 to 22.1 percent in 1969, indicating that export demand was growing twice as fast as total production and domestic demand. In addition, as just noted, exports to the U.S. represented the largest portion of this growth. In fact, by 1970 approximately 50 percent (by value) of Japanese passenger car exports were to the U.S. ($537 million). Nor did Toyota and Nissan dilute their Japanese experience base by building manufacturing plants in the U.S. Instead they put their efforts into developing large car carriers which reduced transportation costs to a fraction of previous levels, improving export effectiveness and adding growth in experience.

Historical and current data comprise the only tool we have in trying to determine whether this competitive trend will continue. Given Japanese pricing practices and pressures, however, it seems likely that Japanese auto producers will continue to drop prices in accordance with cost reductions as they proceed along their cost-experience curves. The two major producers will continue their fight for domestic and export share. Their export thrust will be especially vigorous because this growth segment gives them added experience which can affect their domestic prices and thus their domestic market share. Moreover, monopoly phobia is not a limiting factor in Japan as it is in the U.S. Indeed, the government is encouraging rationalization (mergers) in this industry specifically for the purpose of strengthening international competitiveness. Therefore, no price umbrella situation is likely to emerge. The rate of continued relative price declines, however, will depend on access to export markets as well as on the growth of the domestic market. As has happened with other industries in the past, this export market, especially the U.S. market, is becoming more and more important as demand in Japan slows and its market becomes saturated.

A continuation of this competitive development by Japan's auto industry represents a concrete threat to American auto manufacturers. However there are possible weaknesses in this development, as noted in our earlier policy recommendations regarding export development, antitrust, and control of access to the U.S. market. These and other strategies could be used effectively in this competitive context.

EXHIBIT 15

JAPANESE PASSENGER CAR EXPORTS
1964-1969

(Thousand Units)

	1964	1965	1966	1967	1968	1969
Passenger Cars						
Units	67	101	153	223	406	557
Percent of Total Production	11.6%	14.5%	17.4%	16.2%	19.8%	22.1%