

NOT FOR RELEASE UNTIL AFTER DELIVERY

June 17, 1971, between 2:00 and 3:00 p.m.

INTERNATIONAL TRADE AND INVESTMENT POLICIES FOR THE  
1970's: THE ROLE OF THE UNITED STATES AS PARTNER

Address by

Alfred C. Neal, President  
Committee for Economic Development

Before the

Conference on International Trade in the 1970's

Sponsored by

Royal Institute of International Affairs  
and the Financial Times

Chatham House, London, England

June 17, 1971

This speech was written nearly three weeks ago in New York and reflects an American point of view. What I have to say is more applicable to other members of the OECD than to Britain. I hope, therefore, that any remarks that seem critical will not be interpreted to apply to your country, except as it shares the responsibilities of OECD and may take on those of the Common Market. Moreover, since it was written, the OECD has decided to prepare an agenda for negotiation, perhaps beginning in a year, of some of the difficulties which I describe. However, the OECD agenda does not seem to include the monetary and financial questions which constitute the major focus of what I have to say. The views expressed are of course my own and are not necessarily those of the organizations with which I have been working and which are responsible for much of the information which I have used.

The best way for me to get at the nature of the problems that I want to discuss is to start with the U.S. balance-of-payments deficit. That deficit has persisted for 19 of the last 21 years. The probability is high that it will continue indefinitely if the policies now being followed by the United States and other leading industrial nations are not changed. Until about 12 years ago the deficits could be considered to be performing a useful function. They were providing liquidity for the international monetary system as well as the means of financing the reconstruction of Europe and Japan. The function of supplying liquidity has been taken over by the SDR's, and the "Yankee (dollars) go home!" signs which central banks have hung out is evidence that shortage of dollar exchange is no longer a problem.

Continuation of the deficit in our balance of payments (and here I am referring to the basic balance on current and capital account) is symptomatic of the major international economic problems now confronting the United States. It represents the failure of the international economic system to adjust either automatically or in response to fairly strong policy actions.

The analysis of the problems which we face can be constructed by examining some of the major accounts in the U.S. balance of payments. We can begin with the balance on trade account. For quite a number of years central bankers and others argued that the United States had no real balance-of-payments problem because it had a surplus of exports over imports. But even when that surplus was substantial it was in part illusory. In each of the last ten years it has included from \$1.5 billion to \$3 billion of government financed exports. A report issued last month by the U.S. Senate Finance Committee found that, after adjustment for government financed exports and revaluing imports to a CIF basis, the United States has had an import surplus of about \$4 billion a year since 1968. Without passing on the merits of such adjustments, the significant fact is that the surplus of American exports in the past ten years has declined by more than \$5 billion and for all practical purposes has disappeared. I shall return to the causes of this deterioration a little later.

It is now being claimed by those who wish to curtail foreign investment that the decline in the American trade balance would not have occurred or would be smaller if we had not had the large volume of U.S. private investment abroad. (The annual outflow of our private long-term investments, direct and portfolio, grew from \$2.5 billion in 1960 to nearly \$5.3 billion in 1970.) The imposition of controls over U.S. foreign investments moderated but did not stop this increase. I shall return again to this subject.

The rapid rise in imports and the loss of the trade surplus, together with the increase in private direct investment abroad, has created a major internal political problem in the United States. Industries and interest groups which earlier were neutral or favorable to a liberal policy toward trade and capital movements have become vocally protectionist. The major labor organization

in the United States, the AFL-CIO, now claims that the increasing volume of imports and of foreign investment represents an export of American jobs of such threatening proportions that major changes in U.S. trade and investment policy are essential. The executive council of the AFL-CIO last month called for (1) drastic changes in U.S. tax laws to remove what is claimed to be an incentive to invest abroad; (2) for the creation of disincentives for further production abroad by U.S. based firms; (3) tight controls on investment of U.S. capital abroad and on the export of technology; and more important (4) quantitative restrictions on imports based on the average level of 1965-69.

Nor is organized labor alone in calling for drastic restrictions on imports. The President of the United States has asked for quantitative limitations on imports of textiles and shoes and in a bill that passed the House last year there was included an automatic formula which would have limited the growth of imports of any commodity which had already attained a given percentage of the U.S. market. Quantitative restrictions on imports have been demanded not only by the textile industry and related industries such as clothing, but also by shoes, steel, chemicals and others that are becoming too numerous to mention.

These demands for protection should not be considered lightly. The AFL-CIO since 1934 has supported liberal trade legislation and members of many of its constituent unions have benefitted from the increase in trade which has occurred. While the complaints of textiles, shoes and chemicals are of long standing, the addition to this group of industries like steel, which had until recently been on a net export basis, is ominous. Whereas the Trade Expansion Act of 1962 passed the Congress with relatively little opposition, one of the most knowledgeable and powerful members of the House has said that today the Act would not receive 50 votes in the House. This upsurge in protectionism has

occurred at a time when there is considerable slack in the U.S. economy induced by restrictive monetary and fiscal policies, policies so often urged to bring the U.S. inflation under control and to correct the U.S. balance of payments.

Compounding our difficulty is the determination of protectors of the environment to eliminate pollution at all costs, not excluding the price to be paid in terms of exports that may be lost in the process. Our difficulty is further compounded by the built-in resistance to economic adjustment which is a consequence of the standard of living of the American worker. Workers forced to make adjustment have to give up seniority, pensions and other benefits. Most have an investment in a home and a mortgage that goes with it. It is becoming increasingly difficult to get workers to accept a change of job and we have yet to develop an adjustment program which would overcome these obstacles. We have extensive retraining programs but nothing to take care of the loss of seniority, pensions and other fringe benefits or to take care of the mortgage and other debts. The benefits for workers of buying cheaper goods as a result of international competition have been obscured by the general inflationary rise in prices of imports as well as of domestic goods.

Now let us move to the most intractable of the factors responsible for our balance-of-payments difficulty: it is the deficit on government account. United States government expenditures abroad now run to nearly \$8 billion a year, or \$4.3 billion if aid is eliminated. Despite what many would like to believe, only a fraction of this deficit -- something like \$1-1.5 billion -- is attributable to the universally unpopular war in Vietnam. The biggest part of it is military expenditures in friendly countries that have been allies for almost 25 years. We are now spending on a net basis more than \$1.75 billion in Europe, and another \$0.25 billion in Canada, all for our mutual defense.

Altogether we spend 37 per cent of our budget and nearly 9 per cent of our gross national product on defense (and these figures will be very little affected by the conclusion of the war in Vietnam), whereas our leading trading partners in Europe and fellow members of NATO spend on the average less than half as much relatively.\* Japan, despite substantial increases in recent years, spends but 7.2% of its budget and under 1% of its GNP for defense.

This gloomy review of the international economic position of the United States encompasses some of the major features confronting our Congress and the informed American citizen. These include many of the same people who remember that the United States entered the postwar period in a position of undisputed leadership, animated to make sacrifices in the interest of the large political ideas of peace, collective security, and Atlantic partnership. On the economic front, they were assured that Marshall Plan aid, liberal trade, and a return to convertible currencies would bring prosperity without major problems. For some years there has been a spirit of disillusionment in the land, which has now turned to resentment. The United States position in the world is nearer to radical change for the worse than at any time since the world economic collapse following 1929.

Let me turn now to suggest some solutions for the problems I have outlined.

The United States balance-of-payments deficit is the overriding problem which we must resolve to relieve increasing tension with our trading partners and to restore confidence at home in the foreign economic policies we have been pursuing.

---

\*United Kingdom 17.2% of budget and 5.5% of GNP; France 20.5% of budget and 4.7% of GNP; Germany 24.5% of budget and 3.9% of GNP; Italy 11.3% of budget and 2.9% of GNP. All figures for 1970.

With respect to the U.S. trade deficit, I have alluded to the fact that the trade surplus reported in the official figures is misleading because it contains U.S. government financed exports. There is a further qualification of the figures. U.S. export totals, like those of many other industrial nations, also include exports from international corporations to their subsidiaries abroad. Such exports account for at least one-quarter of total U.S. exports, or about \$10 billion per year. Those, including U.S. labor organizations, who would restrict the operations of international corporations based in the United States would do well to keep that fact in mind.

Those on the European side who would like to restrict the inflow of American capital should take notice of some further facts. We have heard it argued, especially by some European political leaders, that the U.S. balance-of-payments deficit is financing the takeover of Europe by the United States. It would be well to note -- and this is something that politicians seem not to know -- that the U.S. private foreign investment outflow is more than balanced by the return flow of income, royalties and fees. This condition has prevailed for a number of years. In 1970, an outflow of \$5.3 billion was overmatched by a return flow from direct and portfolio investment of \$10.3 billion. The balance-of-payments deficit of the United States is not financing the private investment flow from the United States. On the contrary, the income flowing back to the United States from foreign investments is helping to finance the pleasures of American tourists, the maintenance of military forces of the United States in the rest of the world, and the income on investments realized by foreign capital in the United States. The point I want to stress is that, with the current account in balance and the private capital account in surplus, it can be argued that the U.S. payments deficit is really financing the maintenance

of U.S. government expenditures abroad for the common defense!

But more important from the standpoint of Europe, the transfer of American capital and technology constitutes, as Servan-Schreiber has pointed out, an "economy" in Europe bigger than that of any single country which exports from Europe and an economy that exports more than the American economy exports to the world.

Because of the importance of the international corporation in the technology, exports and income of Europe, it would be the height of foolhardiness for this source of European prosperity to be restricted by Europe. Because of its important contribution to the credit side of the U.S. balance of payments, it would be equally foolish for the United States to restrict it further. In fact, it is foolish even to maintain present restrictions on U.S. private investment abroad. This does not argue, however, for less restriction on short-term money flows; indeed, these and the Eurodollar banking system need to be brought under control. If there is an elephant in the row boat, as Mr. Emminger says, it was Europe who let him aboard!

Now I should like to take up a frequently expressed non-solution to the U.S. balance-of-payments problem. I have heard it argued by economists who are taken seriously that the United States has no obligation to restore its balance-of-payments equilibrium, that this is the problem of those who are receiving more dollars than they want. This is the doctrine of benign neglect. If, these economists argue, the rest of the world does not want to receive more dollars than they can properly use, they should revalue their currency -- meaning that they should devalue the dollar in terms of their own currency. This doctrine assumes either that the U.S. balance-of-payments deficit is a consequence of a difference between the increase in costs and prices in the United States



and those abroad, or that a favorable differential can be established by a change in currency values. The fact is, as these economists and the rest of us know, our inflation has been relatively moderate. It is larger than we want, but it is still less than the inflation that has been experienced in the last ten years by our principal competitors. That inflation is indicative of a problem which the major industrial countries have in common, the inability of policies so far devised to cope with wage-cost-push inflation. The demand that currency revaluation by others be the principal means to correct our deficit suffers from the same flaw as the reliance on fiscal and monetary policies alone to control inflation -- a faulty diagnosis. If the root cause of the persistent U.S. balance-of-payments problem is structural rather than financial, currency revaluations would have to be improbably large to do much good. If, as I have argued, our deficit depends heavily on our government expenditures abroad, then revaluations would hurt rather than help. It does not follow, however, that revaluations would not be helpful on trade and service accounts.

The correct diagnosis, in my view, must begin with the burden of defense expenditures to which I have already referred. That burden is necessary until we have achieved some reasonable reduction in armed forces in agreement with the Soviet bloc, which, despite being the common threat, is becoming one of the larger trading partners of Europe and Japan.\* I do not know the correct defense posture for the West against the East, but I would assert that the burden on the United States of defense expenditures abroad for the mutual security of all of us is too high. The difference of opinion between the

---

\*Our trade turnover with Eastern Europe in 1969 totalled \$444 million, whereas the rest of the free world trade with Eastern Europe in that year totalled more than \$16 billion.

United States and Europe on this question endangers the common security. If negotiations with the Soviet Union do not make it possible for the United States to reduce its military expenditure in Europe, then we must negotiate with Europeans for a substantial reduction in these expenditures, with such assumption of the defense burden as Europe wishes to make on its own.

A second point in the diagnosis that I wish to present is that the United States has been disadvantaged by the formation of the Common Market and will be damaged further by its enlargement. Washington not only has supported but advocated the formation of the European Economic Community, and has long favored British membership. Americans can only rejoice in its success. It is one of the miracles of modern political adaptation. We continue to support British entry and hope that current negotiations will be successful. But there is no ignoring the fact that the six-nation Common Market has had consequences for the United States long forecast by economists. It has had trade diversion effects which have been obscured by the worldwide inflation and by the enormous economic growth which has followed from the formation of the Community. Those trade diversion effects have been most evident in agriculture, where but for still another minor miracle, that of the adaptability of the United States in growing soybeans, we would have seen an absolute decline in U. S. agricultural exports to Europe. Other farm exports to the Community subject to the common agricultural policy have stagnated or declined.

We now confront the fulfillment of the original concept of the European Community -- its enlargement to include Britain, and presumably some of the other members of the EFTA. With that enlargement there will follow a further trade diversion which may cost us several hundred million dollars of exports. The United States will lose large markets for grain in Britain and

in the other countries coming within the common agricultural policy of the Community. Under the GATT rules, as I understand them, a customs union which increases the level of protection owes compensation to those countries which are damaged.

Despite these disadvantages to the United States, as I noted earlier, it has continued to support not only the present Community but also its enlargement. It does not support, however, the use of the buying power of the Community arising from the mere fact of its existence to enter into trade agreements with non-member countries which discriminate against the United States and other third countries. Discrimination both in the form of reduction of trade barriers into the Community and reciprocal reductions by other countries for imports from the Community without their becoming members of the customs union is contrary to the rules of GATT, contrary to the expectations of those who have supported the Community, and is the proper subject of legitimate demands for compensation for damage to trade done.

Let me continue with the diagnosis. With the formation of the EEC there was set in motion a program for the harmonization of border taxes so as to eliminate the need for customs inspectors at common borders of member countries. There had been established in France a tax on value-added long before the Community was formed. In its zeal for the reform of the system, the United States had not only acceded to but probably promoted the GATT rule with respect to direct and indirect taxes. This represents a classic case of what a learned Justice once said: "Sometimes the law is an ass."

I have never been able to find an economist engaged in the negotiation of the GATT agreement who would admit that he was in any way responsible for this monstrosity. It assumes that all indirect taxes are passed on in

prices and that no amount of direct taxes are so passed on. Each principle is faulty in terms of economics that is older than I am but still valid. Nevertheless, in reliance upon those GATT rules and for other very good reasons, the European Economic Community is standardizing upon a value-added tax at a common level of something like 15%. This tax on imports and subsidy to exports will be extended to the EFTA countries which join the EEC. I would argue -- as would many others -- that the United States and other non-member countries are owed compensation for this extension of protection by an indirect route no matter what the GATT rule may be. (An excise on manufactures of from 5% to 20% is also rebated on Japanese exports, much to our disadvantage.)

The restoration of the economies of Europe and Japan is now accomplished. Both areas have strongly monetary reserves and a strong competitive position in trade. Yet each maintains quantitative restrictions on imports, some of which are illegal under the GATT, that hamper American and third country exports. The United States loses two ways. We lose exports, but we also get the full force of Japanese exports which are excluded from Europe by the tight quantitative restrictions maintained there against Japanese exports. Japan cannot and must not be excluded from full participation in the world economic community. The maintenance of quota restrictions by Europe on exports from Japan with the consequences of such action upon the United States and others is a major source of concern to us and incompatible with the strength of Europe's economy.

Still another part of the structural diagnosis relates to government procurement. It is a delicate subject. As in most other cases, we in the United States also maintain restrictions. They are open and spelled out. On ordinary commodities we give a margin of preference of 6 per cent to

domestic producers. (This is double for small business and depressed areas, which supply a small part of the total.) Government procurement in Europe is relatively more important than it is in the United States. European restrictions are not only more onerous, they are virtually hidden from the outsider. Those of the Japanese are even more inscrutable. As in the case of the generalization of anti-dumping procedures, we need to adopt a common code for government procurement so that everyone will know where he stands. Those who do not subscribe to the code should not be eligible sources of supply to those who do.

We now come to the end of this dissertation. It has outlined the dimension of the problem as seen from the U.S. point of view -- unofficially, privately, but with the benefit of study and consideration. It has listed a bill of particulars of monetary, trade and other restrictions exercised by friends and allies against a friend and an ally with a balance-of-payments deficit that will not go away. Continuation of the present trend would be disastrous for both sides. What is called for, therefore, is a frank exposition of positions on both sides and the development of some reasonable solutions which can be negotiated. I have perhaps suggested what some of those solutions might be. Without resolving these trade and payments problems the world may well fragment in ways which cannot be forecast. The benefit of a more rational distribution of the world's production and marketing which is within our grasp could be lost. The basis for a future conflict between economic blocs will have been laid.

What is needed at once is a negotiation which would take an honest look at the structural factors (as well as exchange rate values) which account for the intractable U.S. deficit. Europe is preoccupied with the problems

associated with British entry into the Common Market. So it may take rather strong medicine to gain European attention for the problems of a transatlantic partner. Although the recent OECD decision to prepare a negotiating agenda is encouraging for the longer run, the problem has become so urgent that the United States should not wait to take such action as it can.

Accordingly, I would propose that the United States at once adopt a temporary across-the-board surcharge on imports and subsidy to exports of between 5% and 10%. Such a step would provide some relief of both domestic and international pressures which threaten to blow up the world economic system. The method is preferable, especially in view of our inability to devalue, to establishing a quota system as authorized by the GATT and preferred by a large part of the U.S. Congress. Establishment of the surcharge-subsidy might hasten the negotiation of long-standing differences which must be resolved to provide continuing relief. As that relief is achieved, the tax-subsidy arrangement would, of course, be dismantled.

Once the problem of the U.S. payments balance has been resolved and British entry settled, we can get on with the task of developing the best of a new world in which goods and capital will have free movement, in which the benefits of productivity will be shared by all, and in which living standards can move progressively upward. That is the prospect we must not lose from our vision during the long and difficult days needed to resolve our present difficulty.

# # #