B-B14
Commerce dept. Nov. 75 - July 72.

CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

COPY

January 26, 1972

The Honorable Maurice H. Stans
Secretary of Commerce
Department of Commerce
Washington, D. C. 20230

Foreign Direct Invest.

Dear Maury:

I have given considerable thought to your memorandum of January 14 on "Liberalization and Termination of the Foreign Direct Investment Program." Although I am entirely in sympathy with your objectives, I differ with some specific parts of your proposal.

It would be unwise, in my view, to announce now a date for future termination of the program. My objections to such an announcement are:

1. So soon after the Smithsonian agreement, such an announcement by the United States would be regarded as aggressive by the other participants to the agreement. They would view the announcement as a threat to the structure of exchange rates agreed to on December 18.

2. It would be detrimental to the trade negotiations now under way and to the negotiations foreseen later.

3. It would encourage other countries to erect or reimpose controls on inflows of capital.

4. It would strengthen the opposition of the labor movement and some business people to direct investments overseas. We cannot dismiss lightly their argument that direct investment leads to the export of U.S. jobs. Announcement of termination of the program would strengthen support for the Hartke-Burke bill, which is aimed at both limiting direct investment and fixing quotas for imports.

5. Currently the foreign exchange markets are in an uncertain state. Announcement of termination of the program would put the dollar under additional pressure, increasing the danger that the Smithsonian agreement will unravel.

With regard to the 1972 program, I would suggest some modification in your proposal for collapsing the schedules. It seems to me undesirable to permit companies to shift unused allowables from LDC's to more developed countries. Thus I would suggest that the collapse of the schedules should apply only to the 1972 and later programs. This modification would reduce the amount of the prospective outflow, desirable in any event for the five reasons cited above, and would also reduce adverse political reaction in both developing and developed countries.

I am inclined to go along with your proposals for an increase in the earnings allowable from 40 to 50 per cent and for an increase in the minimum allowable to $6 million.

Sincerely yours,

/S/

Arthur F. Burns

#5.

JAN 14 1972

MEMORANDUM FOR: Honorable John B. Connally
Secretary of the Treasury

Honorable George P. Shultz, Director
Office of Management and Budget

Honorable Arthur F. Burns, Chairman
Board of Governors of the Federal Reserve S

Honorable Herbert Stein, Chairman
Council of Economic Advisers

Honorable Peter G. Peterson
Assistant to the President
for International Economic Affairs

Subject: Liberalization and Termination of the Foreign Direc
Investment Program

We recommend the following program for the phaseout of the Foreign Direct Investment Regulations, pointing to a termination effective December 31, 1973.

1. We would announce a liberalization for 1972 consisting of a collapse of schedules, an increase in the earnings allowable from 40 percent to 50 percent of prior year earnings of foreign affiliates, and a \$6 million minimum allowable (compared to the 1971 minimum allowable of \$2 million for Schedules B/C and a supplemental \$4 million in Schedule A). The cost of such liberalization would be just under \$1 billion or about 40 percent of total current restraint, and would reduce the companies under restraint from about 220 to half that, or 113.

2. In 1973, we would increase the earnings allowable from 50 percent to 75 percent and the minimum allowable from $6 million to $25 million. This would provide an additional cost in 1973 of approximately $850 million, an additional 40 percent of current restraint, and would reduce the companies under restraint to about 30.

3. In 1974, all further restraint in terms of current investment activity would be terminated. The balance of payments cost of this final liberalization would be only approximately $400 or $500 million.

   We would retain control over the repayment of accumulated borrowings resulting from the prior controls. We believe this could be accomplished by the use of voluntary guidelines, but the discipline could be made mandatory if it appeared necessary at that time. A reasonable structure of the guidelines used for repayments of foreign borrowings could create a potential annual outflow of U.S.-source capital for repayment of the foreign borrowings of $2 to $3 billion per year. A greater or lesser outflow could be provided by varying the guidelines.

I would propose that the effective termination date be announced at this time and would also suggest that the same course be followed with regard to the succeeding liberalization stages beyond the 1972 liberalization. I believe this is absolutely necessary in order to redeem the President's commitment to the termination of the controls and I think a vigorous liberalization proposal for 1972 is equally crucial in establishing the credibility of our commitment to termination at the end of 1973.

A possible counter-argument to establishing the termination date at this time is that a specific Administration commitment to termination at this time might increase resistance from organized labor during 1972.

Maurice H. Stans
Secretary of Commerce