Report to the President of the United States

FROM THE TASK FORCE ON

Promoting

Increased Foreign Investment

In United States Corporate Securities

AND

Increased Foreign Financing

For United States Corporations

Operating Abroad

CONTENTS

TERMS OF REFERENCE

As one of 10 actions in his program to reduce the deficit in the U.S. balance of payments and defend U.S. gold reserves, President Kennedy, on October 2, 1963, appointed this Task Force and charged it with developing programs in the three following areas:

(1) A broad and intensive effort by the U.S. financial community to market securities of U.S. private companies to foreign investors, and to increase the availability of foreign financing for U.S. business operating abroad;

(2) A review of U.S. Government and private activities which adversely affect foreign purchases of the securities of U.S. private companies; and

(3) The identification and critical appraisal of the legal, administrative, and institutional restrictions remaining in the capital markets of other industrial nations of the free world which prevent the purchase of U.S. securities and hamper U.S. companies in financing their operations abroad from non-U.S. sources.

In December 1963, President Johnson reaffirmed President Kennedy's charge to the Task Force and asked that its report be submitted to him.

LETTER OF TRANSMITTAL

APRIL 27, 1964.

DEAR MR. PRESIDENT:

As charged by President Kennedy and reaffirmed by you, we have examined ways and means of promoting increased foreign investment in the securities of U.S. private companies and increased foreign financing for U.S. business operating abroad.

Herewith we submit our views as to the nature of the problems, the obstacles to be surmounted, and our recommendations for actions by the private sector and the Government. We have endeavored to limit our recommendations to measures which we believe can produce tangible results within at least the medium term.

It should be recognized that no single recommendation of ours can be expected to have a sudden or dramatic effect on the balance of payments. Carrying out our recommendations will require a broad range of actions by U.S. international business organizations and U.S. financial firms, the executive branch of the Government and the Congress. Efforts by the United States to attract and retain foreign investment can succeed, we believe, only if they occur within a framework of sound U.S. fiscal and monetary policies.

Confident that the programs which we recommend can contribute to reducing the deficit in our international transactions, we pledge our own best efforts toward achieving their success.

Very respectfully yours,

HENRY H. FOWLER,
Chairman.
ROBERT M. MCKINNEY,
Executive Officer.
CHARLES A. COOMBS.
FREDRICK M. EATON.
G. KEITH FUNSTON.
GEORGE F. JAMES.
GEORGE J. LENESS.
ANDRE MEYER.
DORSEY RICHARDSON.
ARTHUR K. WATSON.
WALTER B. WRISTON.
JOHN M. YOUNG.
RALPH A. YOUNG.

THE PRESIDENT,
The White House.

I. Introduction

The magnitude and persistence of past U.S. balance-of-payments deficits, accompanied by large gold losses, have been of increasing concern both to the public and private sectors of our country. This situation, if allowed to continue indefinitely, would endanger our international financial position. During the past 9 months there has been an improvement in our balance of payments. Since some of this improvement may be only temporary, the importance of dealing with the basic factors involved in the problem is in no way diminished.

Significantly, our balance-of-payments deficit does not arise because of any general inability to compete in international markets. Indeed, we have had a large export surplus of commercial goods and services. However, this surplus, which includes the current return from U.S. foreign investments, has not been large enough to offset our Government expenditures abroad for defense and for economic aid, together with our outflow of new private capital.

That our exports of capital—especially in the form of long-term investment—have been on a large scale is natural. The U.S. economy generates a large volume of savings. No other country has a comparable capacity to supply capital both at home and abroad. As a result, the United States has supplied much of the free world demand for capital throughout the postwar period. Returns from these investments, already a major favorable element in our balance of payments, will be even more important in the future.

Nevertheless, concentrated outflows of private capital can create severe difficulties, even for a country with the financial strength of the United States. Difficulties arise particularly when such capital movements occur at a time when the dollar is already under pressure for other reasons. The United States experienced such a combination of conditions in 1962 and early 1963. This created a situation which—had it been permitted to continue unchecked—could have imperiled the stability of the dollar and, hence, of the international monetary system.

These conditions led to a series of actions by the U.S. Government in July 1963. This program included measures to: (1) raise short-term interest rates, (2) reduce further Government expenditures overseas, (3) expand commercial exports, (4) increase foreign tourism in the United States, and (5) finance the balance-of-payments deficit in ways that result in a minimum drain on our gold stock. In addition, the President requested congressional approval of the proposed interest equalization tax on purchases of foreign securities by U.S. residents, designed as a temporary expedient to stem the accelerating outflow of private capital into foreign portfolio investments. In his message presenting this program, President Kennedy announced his decision to create this Task Force and set forth its terms of reference.

In carrying out its assignment, the Task Force called for advice and assistance from major segments of the U.S. industrial and financial communities. The counsel received from representatives of investment banking and brokerage firms, securities exchanges, investment companies, commercial banks and industrial corporations has contributed greatly to the effectiveness and realism of the Task Force's deliberations.

The purpose of our report is to set forth actions which we recommend be taken by the U.S. private sector and the U.S. Government, designed—

1. To improve the U.S. balance of international payments by increasing foreign investment in U.S. corporate securities;
2. To guide U.S.-based international corporations into making increased use of the pools of savings now accumulating in industrial nations in which they do business; and
3. To help establish conditions under which restraining influences on capital flows between the industrially advanced countries—including the proposed U.S. interest equalization tax—can be removed, diminished or allowed to expire.

Because of the favorable prospects for the U.S. economy, some of the savings accumulated in other industrial countries are flowing here for investment. It is not unreasonable to expect that this flow could be increased, particularly if U.S. taxation of foreign investors and other inhibiting factors were alleviated and our private selling efforts reinforced.

The incentives and influences governing international capital flows are, however, complex and not wholly predictable. Habits and fears derived from a lifetime of experience with wars, inflation, depressions, and crises are at least as important in influencing investment decisions as are the day-to-day movements of security prices, dividend rates and economic indicators.

Against this background, the main concern of the Task Force has been to satisfy itself that its recommendations will operate in the right direction, and as promptly as possible.

The findings and recommendations of this report are directed to four main areas:

First, the U.S. financial community; that is, investment banking and brokerage firms, commercial banks, investment companies and securities exchanges.

Second, U.S. industrial corporations with substantial operations overseas.

Third, U.S. taxation of foreign investors in U.S. securities and the clarification of questions which have arisen in connection with the administration of Federal securities laws.

Fourth, the reduction—or elimination, where circumstances permit—of monetary, legal, administrative and institutional restrictions abroad which inhibit investment by foreigners in the securities of U.S. corporations and which hamper U.S. companies in financing their oversea operations from foreign sources.

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II. Actions Involving the U.S. Financial Community

This section of the report presents our views as to measures which the U.S. securities industry—brokers, dealers, investment bankers, securities exchanges, and investment companies—and commercial banks, in cooperation with U.S. corporations whose shares are publicly held, can take to increase the ownership of U.S. corporate securities by investors in the other industrial nations of the free world.

Direct ownership of equity securities by the public is not nearly so broad in other countries as in the United States. Foreigners owning U.S. securities tend to be wealthy, sophisticated investors. In most countries facilities for serving a broad investing public have not been developed as intensively as in the United States. Most investors abroad encounter difficulty in obtaining information about companies and securities. Securities transactions are generally handled through banks which make little or no effort to encourage equity investment by customers with small accounts. Indirect ownership of equities through institutions, such as pension and insurance funds, is at a less-developed stage abroad than in the United States; moreover, the number and size of such institutions are considerably smaller than in the United States. Despite these circumstances, we believe foreign purchases of U.S. securities can be significantly expanded.

Our recommendations here are concerned with (1) selling U.S. corporate securities abroad, (2) adapting U.S. corporate securities to foreign markets, (3) selling U.S. investment company shares abroad, (4) providing information to foreign investors, and (5) attracting foreign bank deposits.

Selling U.S. Corporate Securities Abroad

Recommendation No. 1:

U.S. investment bankers and brokerage firms should intensify their efforts to develop facilities for reaching foreign investors directly.

Recommendation No. 2:

U.S. investment bankers and brokerage firms should seek modification of foreign regulations and practices which unduly restrict the ability of U.S. firms to promote the sale of U.S. securities or to deal directly with potential foreign customers.

Foreigners may buy U.S. corporate securities by: (1) placing orders with foreign banks or brokers, who in turn may either place the orders with U.S. firms for execution in the U.S. market or execute the orders on a foreign exchange or in the foreign over-the-counter market; or (2) placing orders directly with brokers in the United States or with their oversea offices for execution in the United States. However, not all of these channels are open in all countries.

Despite the recent growth in offices of U.S. brokerage firms abroad, sales efforts by U.S. brokers are hampered in most foreign countries by restrictions on advertising or direct approaches to potential investors. In some countries, U.S. brokerage firms are prohibited from soliciting securities business of any kind. In others they are permitted to deal only with banks.

Opportunities may exist to open new channels for dealing directly with the local investing public. Every effort should be made to find and utilize such opportunities, even though it may require modification of established practices or governmental regulations.

Recommendation No. 3:

U.S. investment bankers and brokerage firms, with the cooperation of interested U.S. corporations, should endeavor to obtain shares of U.S. corporations for distribution abroad.

In certain cases it may be possible for U.S. securities firms to obtain blocks of U.S. securities for distribution exclusively abroad. Distribution abroad may involve a greater amount of time and effort and, possibly, greater compensation to foreign broker-dealer firms than would distribution in the United States. However, as pointed out below, certain circumstances may be present which would significantly increase the attractiveness of exclusive oversea distribution.

One source of such blocks would be outstanding securities that would have to be registered with the Securities and Exchange Commission (SEC) if sold in the United States. However, because of the time and expense involved, or for other reasons, it may not be desirable to register such blocks. Holders of such securities might prefer to have U.S. securities firms undertake distribution abroad, and thus avoid the inconvenience and cost of registration with the Securities and Exchange Commission. U.S. corporations could cooperate by directing attention of large stockholders to the possible advantages of selling blocks in foreign markets.

Where the expenses can be justified by sound business purposes, interested U.S. corporations might be willing to absorb costs of distributing their shares abroad. In such circumstances, blocks of shares could be provided by two means: First, corporations wishing to raise additional capital could, where feasible, issue new shares for sale abroad. Second, corporations which consider it advantageous and practical to have increased foreign ownership of their shares, but which do not need new capital, might have blocks of their outstanding shares acquired in the open market for eventual redistribution abroad.

It would be shortsighted, however, to take advantage of lack of regulations in other countries comparable to those of the Securities and Exchange Commission in the United States. As long as adequate disclosures are made when issues are being offered abroad, there should be no need to go through the formality and expense of registration in the United States.

Recommendation No. 4:

The Securities and Exchange Commission should issue a release setting forth the circumstances under which it would normally issue a "no action" letter providing that no registration be required on public offerings of securities outside of the United States to foreign purchasers, including dealers.

The Securities and Exchange Commission heretofore has been helpful in issuing "no action" letters in individual cases when the facts permitted. If a general policy could be set forth, however, it would clarify the position of the Commission in this regard and facilitate the activities of U.S. investment bankers in foreign markets. It would also be helpful if such a policy statement indicated that (1) a simultaneous private placement of the same securities in the United States would not prevent the issuance of a "no action" letter, and (2) the sale could be conducted from and closed in the United States.

Recommendation No. 5:

The Securities and Exchange Commission should issue a release eliminating the requirement that foreign underwriters participating exclusively in distributions of securities to non-residents of the U.S. register as broker-dealers.

Foreign securities dealers are often asked to participate in a U.S. underwriting or selling syndicate. Although the Securities and Exchange Commission has attempted on a case-by-case basis to free such foreign dealers from the necessity to register as broker-dealers, enough uncertainty remains to make this situation an impediment to the successful distribution of U.S. securities abroad. There should be no requirement for foreign brokers to register even though they may belong to an underwriting or selling group, other members of which are engaged in the distribution of the same securities in the United States.

Recommendation No. 6:

U.S. investment bankers should include foreign banks and securities firms as underwriters, whenever possible, or as selling group members in new offerings and secondary distributions of either domestic or foreign securities.

The inclusion of foreign banks and securities firms as members of the underwriting groups for domestic or foreign securities would directly involve them in the responsibility for the successful distribution of a portion of the offerings abroad.

Recommendation No. 7:

U.S. investment bankers and brokerage firms should organize the underwriting and distribution of dollar-denominated foreign securities issues so that the maximum possible amount is sold to investors abroad.

In the past several years, sales to foreigners of new securities issues underwritten in the United States have been primarily foreign government and foreign corporate bonds (including convertible debt securities) denominated in U.S. dollars. Since the proposal of the interest equalization tax, however, such issues in the U.S. capital market have been practically nonexistent. When final action has been taken on the tax and the market for newly issued foreign securities reopens, U.S. investment bankers should endeavor

to place the largest possible proportion of these securities abroad in order to minimize the impact on our balance of payments. (From the standpoint of the foreign borrower whose securities are subject to the interest equalization tax, this will reduce the amount of the issue subject to the tax.) Similar efforts should be made with respect to foreign securities offered in the U.S. market which are exempt from this tax.

Recommendation No. 8:

U.S. commercial banks should intensify efforts to attract foreign trust accounts for investment in U.S. corporate securities.

Typically, trust accounts of foreigners managed by U.S. commercial banks are invested in U.S. securities; thus their growth is a positive factor in our balance of payments. New trust accounts could be solicited by: (*a*) more intensive use of foreign branches for this purpose; (*b*) oversea sales visits by trust officers; and (*c*) establishment of oversea trust companies or related facilities.

Recommendation No. 9:

The Securities and Exchange Commission should serve as an information center regarding listing requirements, and distribution regulations and practices abroad.

The Securities and Exchange Commission has expressed to the Task Force its willingness to serve as a clearinghouse for information on relevant foreign securities laws and practices and on issuers' experiences in selling securities overseas.

Adapting U.S. Corporate Securities To Foreign Markets

Recommendation No. 10:

Major U.S. corporations should arrange for U.S. banks and trust companies to issue, through their foreign branches and correspondents, depositary receipts for U.S. corporate shares.

The Task Force believes that depositary receipts in bearer or registered form, which would be "good delivery" internationally, would be useful in facilitating foreign investment in U.S. corporate securities. Trading of depositary receipts on foreign stock exchanges would be facilitated by having them (1) denominated in fractions of whole shares, thus bringing the unit prices closer to those customary in foreign markets, and (2) printed in the language of the country in which they are to be traded.

The costs of the depositary receipts now available to European investors are borne by the holders. Corporations whose securities are already available in depositary receipt form, or who wish to initiate depositary receipt arrangements, should consider absorbing some of the costs of the service. Some foreign corporations whose shares are traded in the United States in the form of American Depositary Receipts presently bear such costs.

Selling U.S. Investment Company Shares Abroad

Foreign holdings of U.S. investment company shares have shown a steady increase over the years. Initial foreign participation was primarily through purchase of shares of closed-end investment companies. A few of these have had, and continue to have, substantial foreign shareholders; some are listed on European stock exchanges. With the cooperation of the companies concerned, foreign interest in this medium for investment in the U.S. economy can be increased.

Since the foreign distribution of U.S. open-end investment company (mutual fund) shares is largely through banks and brokers, opportunities for direct solicitation by the issuers are limited. A few specialized U.S. sales organizations solicit foreign investors directly, primarily in countries without developed financial institutions.

Recommendation No. 11:

U.S. investment companies should plan and carry out a program to acquaint foreign investors with the advantages of owning U.S. closed-end investment company shares.

Recommendation No. 12:

Distributors of U.S. open-end investment company shares should devise methods for achieving additional foreign distribution of such shares, where locally permitted.

Recommendation No. 13:

U.S. investment company distributors should seek the modification of foreign regulations and practices which restrict the availability of their shares to foreign investors.

Recommendation No. 14:

U.S. closed-end investment companies should seek to place original and secondary offerings of their shares with foreign investors and, where feasible, list these shares on major foreign exchanges.

The Investment Company Institute has agreed to inform its member companies of the objectives of this Task Force, suggesting that they undertake more active study of foreign distribution opportunities. Some foreign banks and securities dealers on which U.S. investment companies depend for distribution offer shares of their own investment companies. Nevertheless, there are banks and other potential distributors in Europe and elsewhere who do not have competitive issues to offer. More aggressive search for such distributors would undoubtedly develop additional sales.

In addition, the Institute is studying the feasibility of a detailed country-by-country review of legal, tax, and registration requirements to assist the educational and promotional efforts of U.S. mutual fund sponsors. It is also considering translation into foreign languages of basic materials describing investment companies.

Providing Information to Foreign Investors

The flow of information on securities markets and individual corporations which the U.S. public receives as a matter of course from the press, radio, brokerage firms, advisory services, and directly from companies is unique. Abroad, comparable information is not readily available. Thus information disclosed by publicly owned U.S. corporations is one of our most effective potential aids as we seek to channel a growing share of foreign savings into U.S. investments.

Recommendation No. 15:

In order to promote the purchase of U.S. corporate securities abroad—

(*a*) the U.S. financial community should cooperate closely with major U.S. corporations in the dissemination of corporate reports in foreign languages and in the publication of financial data in foreign newspapers;

(*b*) U.S. investment bankers and brokerage firms should prepare research and statistical reports in foreign languages for distribution to foreign investors through local banks and secu-

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rities firms and promote the publication of more detailed U.S. stock market and financial information in the foreign press;

(c) facilities of U.S. commercial banks should be fully utilized to distribute to foreign financial institutions and investors reports, preferably in foreign languages, on the U.S. economy;

(d) U.S. securities exchanges should take advantage of new communication techniques and reduced rates to promote broader use abroad of stock quotation and financial news services;

(e) U.S. investment bankers and brokerage firms should offer securities orientation and sales training programs to personnel of foreign banks and securities firms; and

(f) U.S. investment bankers, brokerage firms and securities exchanges should work with their foreign counterparts and the foreign press to broaden share ownership by foreign investors.

Some U.S.-based international companies already publish reports in foreign languages. Distribution of reports directly to investors abroad is more difficult than in the United States, however, and is complicated by the predominant foreign practice of not registering shares in the names of beneficial owners. Consequently, it is necessary for such companies to work closely with foreign banks to insure that their reports reach the actual shareowners. Companies also should take particular care to include the foreign news services and the foreign press in news distributions.

U.S. securities firms are an important channel abroad for market information on U.S. securities. But since local regulations or traditions limit their ability to reach the public directly in many countries, U.S. firms now concentrate their efforts on supplying material to foreign banks and brokers. Still missing, however, is a means for providing broader circulation of U.S. market news to the general public abroad. To fill the requirement, U.S. securities firms with foreign offices should supply local newspapers with abridged tables of prices of U.S. securities converted to local currencies. They should ascertain and provide the type of daily market news foreign papers will publish.

U.S. commercial banks now do a thorough job of keeping U.S. firms informed of financial conditions abroad. Beyond this, they

should intensify their efforts to acquaint foreigners with the general desirability of investing in the United States.

The full stock ticker service, which until now has been prohibitively expensive outside the United States and Canada, is making its appearance overseas. Because up-to-the-minute price information is a necessary brokerage service, this should encourage foreign investment in U.S. securities.

Personnel of foreign banks and brokerage firms who deal directly with ultimate purchasers abroad often have little knowledge of U.S. securities or U.S. market procedures. Representatives of U.S. international securities firms should consider offering such personnel condensed versions of the training given registered representatives in the United States.

Educational programs designed to broaden share ownership would be advantageous to all industrialized countries. Here the U.S. securities industry can play a constructive role, both directly and by assisting their foreign counterparts in devising and conducting their own information programs.

Attracting Foreign Deposits in U.S. Banks

Recommendation No. 16:

The Congress should adopt legislation discontinuing mandatory regulation of maximum interest rates on domestic and foreign time deposits.

Recommendation No. 17:

Pending adoption of such legislation, the Federal Reserve Board of Governors should administer Regulation Q in a flexible manner permitting U.S. commercial banks to meet internationally competitive interest rates on both domestic and foreign time deposits.

Foreign time deposits with maturities exceeding 1 year in U.S. banks are similar to foreign purchases of long-term securities in their effect on the U.S. balance of payments. Encouraging such deposits thus is clearly within the terms of reference of the Task Force.

While an increase in short-term deposits in the United States by foreigners would not reduce the U.S. payments deficit as customarily defined, it would tend, at least temporarily, to reduce the volume of liquid dollar assets that foreign central banks might use to buy gold.

Similarly, greater short-term investment in this country by U.S. residents and corporations who would otherwise place their funds abroad would directly reduce the U.S. payments deficit.

The growth in time deposits in U.S. banks in recent years has reflected increases in rates paid on such deposits, following increases in the maximum rates under regulations of the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation. Foreign official time deposits have likewise risen substantially since their exemption from regulation in October 1962.

The objective of increasing commercial banks' ability to compete for foreign time deposits could be enhanced either (1) by legislation completely abolishing the power of the Board of Governors of the Federal Reserve System to regulate maximum interest rates on time deposits, or (2) by placing that authority on a standby basis, as the present administration has proposed. Members of the Task Force are divided in their opinion as to which of these alternatives should be used to achieve this objective; hence no recommendation as between these alternatives is made.

III. Actions Involving U.S.-Based International Corporations

Dividends, interest, and other receipts from existing U.S. direct investments abroad have, in recent years, been about twice as large as our new direct investment outlays in foreign countries. It is clear, therefore, that foreign operations of U.S.-based international corporations are already making an important positive contribution to the U.S. balance of payments. Nevertheless, for limited periods of time and with respect to certain areas of the world, our outflows of capital can exceed our receipts from those areas. Hence, it is also clear that programs designed to (1) increase foreign ownership of the shares of U.S. corporations and (2) maximize the use of foreign sources of finance can increase the overall positive contribution which U.S.-based international corporations make to the U.S. balance of payments.

We set forth below specific programs we believe will be of interest to managements of international corporations based in the United States. These programs are not presented as detailed prescriptions for action, since the complexity of the subject matter makes that impossible. Rather, they are suggested as general procedures which might prove feasible under certain circumstances.

Increasing Foreign Ownership of the Securities of U.S. Corporations

Increasing foreign ownership of the securities of U.S. corporations will require initiatives by both the U.S. private and public sectors. In section II we have discussed actions by brokerage and investment banking firms, investment companies, commercial banks, and the securities exchanges. In this section we take up actions by the corporations themselves.

Recommendation No. 18:

U.S.-based international corporations should consider the advantages of increased local ownership of their parent company shares in countries in which they have affiliates.

Recommendation No. 19:

Where consideration under Recommendation No. 18 above is favorable, corporations should collaborate with the U.S. financial community in encouraging greater foreign ownership of their shares.

In addition to the balance-of-payments impact, there is yet another dimension to the role of free world international corporations, wherever based. Through their plants, distribution facilities and other business operations, strong local relationships have been developed to encourage and support their growth. These relations would be further strengthened if they were extended to include that of corporation to stockholder.

Recommendation No. 20:

U.S. securities exchanges should submit a plan acceptable to the Securities and Exchange Commission permitting U.S.-based international corporations to encourage foreign ownership of their stock.

Under this plan, which would be publicly announced and open to all brokers, a corporation would be permitted to pay whatever compensation is necessary to achieve distribution of its securities abroad. The broker receiving the compensation would be permitted to pay all or part of such compensation to the employee or foreign broker producing the order. Once initiated, such a plan would continue until terminated by the corporation.

Recommendation No. 21:

The Treasury Department should issue a ruling that would establish the tax deductibility of costs incurred by U.S. corporations in arranging for securities firms to place their securities outside the United States as part of programs to improve their oversea relationships.

The Task Force recognizes that any plan undertaken by a corporation to distribute its shares abroad would involve certain costs. However, in many cases, the good will which would be created by corporations having a substantial number of shareholders in other countries where they do business might be considered to justify the costs. Since many U.S. corporations have already adopted programs in the nature

of institutional advertising, designed to improve their oversea relationships, it would appear that any expenses incurred in encouraging securities firms to place stock overseas as a part of these programs should be appropriate deductions from taxable income as ordinary and necessary business expenses.

Recommendation No. 22:

Corporations should collaborate with U.S. investment bankers in the utilization by the latter of techniques for distribution abroad of new or secondary issues of their stock.

Some corporations may find that there are advantages in having blocks of their stock sold abroad. U.S. investment bankers can suggest a variety of means by which such blocks can be made available for distribution abroad. The cooperation of the U.S. corporations involved is essential to the success of such a distribution.

Recommendation No. 23:

U.S. corporations should offer their shares to employees in foreign countries where stock purchase, supplemental compensation or other incentive plans are feasible and desirable.

Many U.S. corporations encourage employee ownership of parent company shares; some offer financial incentives to promote such ownership by their oversea employees. Most countries permit such plans, although some restrict purchase of foreign shares by their nationals. Where savings plans for foreign employees are currently in force or are under consideration, parent company stock could form an important feature of such plans, subject, of course, to local regulations. Funded pension plans of foreign affiliates may also offer scope for greater investment in U.S. securities.

Many foreign nationals employed by U.S. companies abroad may be unfamiliar with shares but may have had experience with interest-paying investments. Hence, convertible bonds of the parent companies or of their subsidiaries would be in some cases attractive instruments for employee savings plans.

Recommendation No. 24:

U.S.-based international corporations should consider the advantages of listing their shares on foreign stock exchanges.

Many large U.S. corporations are not listed on foreign stock exchanges; other U.S. companies are listed on exchanges of some countries but not on others. Although most foreign trading in listed U.S. corporate securities will probably continue to take place on exchanges in New York, listing of such securities on foreign securities exchanges should stimulate their purchase by foreigners. Financial and other information regarding U.S. corporate issuers derived from listing applications and reporting requirements would be disseminated abroad in local languages. Also, listing would assist in creating local markets for such securities, an important consideration in connection with local public offerings or large private placements of securities.

After initial holdings of their stock abroad have been established, U.S.-based international corporations should make every effort to insure adequate continuing local markets for the shares.

Maximizing the Use of Foreign Sources of Debt Financing

Foreign debt financing raises fewer policy issues for U.S. corporations with foreign subsidiaries than does the issuance and sale of equity securities. The primary factors to be considered are the relative availability of loan funds, the costs of such financing considered in conjunction with exchange risks, and the basic characteristics of local sources of finance.

Many countries strictly limit access to their capital markets by all borrowers. They also limit the amount of credit even if access is gained. It should be emphasized, however, that these limitations are less severe with respect to local companies, even though they may be affiliates of U.S. parent corporations.

Generally speaking, the level of interest rates and other financing costs tend to be higher abroad. These costs and other limitations have been of greater importance in long-term debt issues than in short- and medium-term financing from banks and other financial institutions. Accordingly, many oversea subsidiaries have relied on short-term financing to a greater degree than would be considered sound financial practice in domestic operations.

Such short-term loans are actively sought by foreign banks and foreign affiliates of U.S. banks, within the limits of available funds and local government policies. These banking connections have become important sources of local influence and information for U.S. business firms operating abroad. Consequently, they are often relied on even where costs may be somewhat higher than for other sources of financing.

In this connection, the Task Force notes that the ability of oversea branches and affiliates of U.S. banks to provide foreign debt financing is enhanced by making Public Law 480 and other counterpart funds available to such branches and affiliates. This practice, already of long standing, should be encouraged to the greatest extent feasible consistent with other objectives of the program, where possible placing such funds on a long-term basis and thereby facilitating badly needed capital loans.

Recommendation No. 25:

U.S.-based international corporations should instruct their senior officers and policy groups to keep foreign financial operations under constant review, examining as standard procedure all proposals for new financing from the standpoint of the effect of their actions on the U.S. balance of payments.

With achievement of a high degree of convertibility and the diminution of exchange risks, the incentives for maximizing foreign sources of financing are not as strong as several years ago. Nevertheless, we believe that the introduction of U.S. balance-of-payments considerations into all corporate financial decisions could do much to increase corporate borrowing abroad.

All corporations operating abroad, as a matter of routine, rely on normal trade credits, accrued tax liabilities, and other sources of working capital not involving borrowing. These sources are significant and opportunities for further expansion should be actively sought.

Recommendation No. 26:

U.S.-based international corporations should, where feasible, finance their foreign operations in a manner which minimizes the outlay of cash.

The use of securities where foreign properties are being acquired improves the balance of payments to the extent that it reduces the immediate outflow of cash funds from the United States or avoids the use of funds which otherwise might be remitted to the United States. Many governments actively solicit the establishment of foreign firms in developing regions. Special inducements are offered, such as low rentals for new plant facilities, tax advantages, and attractive local financing. By taking advantage of these opportunities, U.S. companies planning to produce abroad can reduce the need for capital funds from the United States.

U.S. corporations investing overseas should examine the possibility of utilizing foreign currency loans (the so-called "Cooley Loans") made available in certain countries by the U.S. Government out of receipts from the sale of surplus agricultural commodities under Public Law 480.

Recommendation No. 27:

In cases where new capital is required, U.S.-based international corporations should consider, in appropriate cases, broadening local ownership by offering in foreign capital markets bonds or preferred stock of their local affiliates convertible into common shares of the U.S. parent corporation.

Convertible securities should appeal to foreign investors because they can be designed to provide—in addition to conversion privileges—the interest rate, maturity, sinking fund, redemption, and other provisions conforming to the local markets' requirements. Whether converted or not, and whether issued in dollar denominations or in the currency of a foreign country, the sale of such securities would reduce the amount of direct dollar investment by U.S. parent companies. As the issuer of the securities would be a foreign subsidiary, a foreign purchaser would be free of U.S. tax on the dividends or interest payments, although shares issued on conversion would be those of the U.S. parent.

Recommendation No. 28:

U.S.-based international corporations should be encouraged to make available, through trade or banking channels, specific case studies of foreign financing operations to small- or medium-sized U.S. firms interested in foreign operations but less aware of foreign financing opportunities.

As we have seen, commercial banks and agencies of foreign governments provide U.S. firms with information on foreign financing. Industrial corporations and trade associations through well-organized programs could supplement this information by providing special information for U.S. firms planning to operate abroad. Specific case studies of foreign financing operations of individual industrial corporations could be distributed by the corporations themselves or by business schools and business and financial organizations. Such studies would also be appropriate for seminars in schools of business administration. They would be invaluable to small- and medium-sized corporations which may be less aware of the opportunities for foreign financing and its implications for the U.S. balance-of-payments problem.

IV. Actions Involving the U.S. Government

Efforts by the private business community to market U.S. corporate securities to foreign investors and to increase the availability of foreign financing for U.S. corporations operating abroad should be accompanied by U.S. Government efforts to reduce existing deterrents to these activities which arise from practices, regulations, and law here and abroad.

Preceding sections of this report have referred to specific areas where the modification of U.S. laws and Government practices—as administered by the Treasury Department, the Securities and Exchange Commission, and the Federal Reserve Board—would facilitate private programs. In this section, we recommend revision of U.S. taxation of foreign investors in U.S. securities. The Task Force wishes to stress that no tax concessions to U.S. corporations or individuals are recommended. Our recommendations here relate solely to the removal or reduction of obstacles to foreign investment in U.S. securities.

The U.S. Government should take appropriate action where monetary, legal, administrative, and institutional restrictions in other countries inhibit the purchase of U.S. corporate securities by foreign investors and hamper U.S. companies in financing their oversea operations from foreign sources. Primarily, this will involve diplomatic initiatives, either bilaterally or multilaterally. This section will also identify foreign governmental restraints and practices to which diplomatic initiatives should be addressed.

As might be expected, views held by various members of the Task Force reflect the division of opinion over the desirability of the interest equalization tax, fully developed in hearings before the House Ways and Means Committee. It does not seem necessary to review these differences here; nevertheless, nothing said or unsaid in this report is intended to represent any departure from the views individual members may continue to hold on this subject.

Revising U.S. Taxation of Foreign Investors

Revision of U.S. taxation of foreign investors is one of the most immediate and productive ways to increase the flow of foreign capital to this country.

Our recommendations for changes in taxation of foreign investors are intended to remove a number of elements in our tax structure which unnecessarily complicate and inhibit investment in U.S. corporate securities without generating material tax revenues. They are not intended to turn the United States into a tax haven, nor to drain funds from developing countries.

Basic Provisions in Internal Revenue Code for Taxation of Nonresident Alien Individuals and Foreign Corporations

Except as provided in tax treaties with certain countries, nonresident alien individuals not engaged in trade or business in the United States are taxed at a minimum of 30 percent on (*a*) dividends, interest, and other periodic income from U.S. sources, and (*b*) capital gains in the United States under the circumstances specified below. This 30-percent tax is applied against gross income and is withheld at the source, except in the case of taxable capital gains and other minor exceptions. If such gross income from U.S. sources in any year exceeds $19,000,[1] nonresident alien individuals are required to compute the tax on their U.S. source net income at regular rates if this method of computation yields a higher total tax than the minimum 30 percent tax on gross income. Nonresident alien individuals engaged in trade or business within the United States are, in general, subject to tax on all their U.S. source income, including capital gains (whether or not derived from the conduct of such trade or business) on the same basis and at the same rates as U.S. citizens.

Nonresident alien individuals not engaged in trade or business in the United States are taxed, at rates specified above, on capital gains realized in the United States if they are (*a*) physically present in the United States for 90 days or more during a taxable year, or (*b*) physically present in the United States when the gain is realized.

The U.S. property of nonresident alien decedents (which by definition includes shares of U.S. corporations) is subject to U.S. estate tax at normal rates.

Foreign corporations engaged in trade or business in the United States are taxed on all of their U.S. source income, whether or not derived from the conduct of such trade or business, on the same basis and at the same rates as domestic corporations. Foreign corporations not engaged in trade or business within the United States are taxed at a flat rate of 30 percent on the gross amount of dividends, interest, and other periodic income received from U.S. sources, but are not taxed on capital gains.

In addition, any foreign corporation meeting the personal holding company tests is subject, with certain exceptions, to a tax of 70 percent on its undistributed personal holding company income. Moreover, if any such corporation derived more than 50 percent of its gross income for a 3-year period from U.S. sources, that percentage of its dividends equal to the percentage of its gross income derived from U.S. sources is treated as U.S. source income to the shareholders themselves and taxed accordingly.

[1] $21,200 in 1965 and thereafter.

Reciprocal tax treaties in effect with most of the industrialized countries of the world modify the basic provisions of the Internal Revenue Code which are summarized above. Most of the treaties reduce the rate of withholding tax on dividends and interest paid to residents (both individuals and corporations) of the treaty country. Typically the rate is reduced from 30 percent to 15 percent on dividends and from 30 percent to 15 percent, or in some cases zero, on interest. The provisions for progressive taxation of individuals whose income from U.S. sources in any year exceeds $19,000 generally are eliminated. Certain treaties eliminate capital gains tax liability. Most of the benefits available to foreign investors under the treaties are restricted to residents of the treaty country who are not engaged in trade or business within the United States through a permanent establishment.

Specific Recommendations

Our recommendations have been conceived as a package, designed in part to simplify the tax laws and reporting requirements applicable to foreign investors, in part to reduce taxation of foreign investors and in part to make evident to the world that the United States welcomes foreign investment. To the degree that the package approach is discarded and the package is broken down into its components, some being accepted and other rejected, more of the potential impact will be lost than might necessarily be expected by analysis of the financial effect of any particular proposal.

The major source of U.S. tax revenue from foreign investors is the withholding tax currently imposed on dividends and interest paid such investors by U.S. corporations. We have not recommended the removal of, or a reduction in, this tax. Thus adoption of our recommendations would not materially reduce tax revenues and would leave intact the major bargaining point for the United States should it desire in the future to negotiate new or modified reciprocal tax treaties with other countries.

The withholding tax on dividends and interest, in some cases, certainly deters investment by foreigners in the United States, and the different rates of withholding tax provided by the Code and the various treaties are a source of confusion. The United States should, however, first attempt to attract foreign investment by attacking the several areas of taxation that deter investment without generating material revenues.

Adoption of our recommendations would not eliminate the need to extend and modernize our tax treaties. Among other desirable changes: the United States should work for the reciprocal reduction of withholding taxes on dividends and interest and toward reciprocal elimination of all taxes on the income of pension trusts and similar investors that are exempt from tax in their country of residence. Such changes will, however, take time.

Recommendation No. 29:

Eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents.

U.S. estate taxes, especially as applied to shares of U.S. corporations owned by nonresident alien decedents (which are subject to U.S. estate taxes irrespective of whether they are held in this country or abroad), are believed to be one of the most important deterrents in our tax laws to foreign investment in the United States. U.S. estate tax rates are materially in excess of those existing in many countries of the world and, despite the treaties in effect with several countries, the taxes paid on a nonresident alien decedent's estate, some portion of which is invested in the United States, generally would be greater than those paid on a nonresident alien decedent's estate, no portion of which is invested in the United States. We understand that the revenues received by the United States as a result of estate taxes levied on intangible personal property in estates of nonresident alien decedents are not large.

Under existing U.S. tax law, a foreigner willing to go through the expense and trouble of establishing a personal holding company, incorporated abroad, and assuring himself that this personal holding company does not run afoul of the U.S. penalty taxes on undistributed personal holding company income, can already legally avoid estate taxes. Consequently, for such an investor U.S. estate taxes are avoidable through complicated and expensive procedures, while for other foreign investors they are likely to result in a considerable tax penalty. This is an unsound situation which directly deters foreign investment in the United States and significantly worsens the overall image of this country as a desirable place to invest.

Recommendation No. 30:

Eliminate (with respect to income not connected with the conduct of a trade or business) the provisions for progressive taxation of U.S. source income of nonresident alien individuals in excess of $19,000 and provide that no nonresident alien whose tax liability is fully satisfied by withholding shall be required to file returns.

The provision for progressive taxation of foreign investors and the companion requirement to file returns, in our opinion constitutes one of the major sources of confusion and misunderstanding for potential foreign investors in the United States. The revenues produced by this tax are understood to be negligible. Progressive taxation of foreign investors does not exist in many other industrialized countries of the world.

Treaties with most industrialized countries already eliminate the provision for progressive taxation of nonresident alien individuals who are residents of treaty countries. However, there are throughout the world vast sums of capital that have left their countries of origin. Typically, these funds are held in treaty countries by residents of nontreaty countries. If the provisions for progressive taxation of nonresident alien individuals were removed from the Code, the position of the United States in competing with other industrialized nations for such capital would be strengthened.

Furthermore, we must recognize that the actual fiscal impact of this, or any other, tax law on the persons to whom it applies does not measure the extent to which the law deters or limits potential investment by persons who are unwilling or unable to master its complexities. This is especially true when dealing with foreigners, whose familiarity with U.S. laws and practices is limited. Even those foreigners with substantial funds available for investment often find it troublesome and expensive to obtain sound U.S. tax advice, with the result that they channel their investments elsewhere.

Were the Internal Revenue Code amended to eliminate progressive taxation of nonresident alien individuals not engaged in trade or business within the United States, the entire U.S. tax liability of substantially all such aliens would automatically be fully satisfied by withholding at the source. These aliens would have no actual, or potential, additional tax liability and no returns to file. There could be no confusion as to the applicability of our tax laws to them. This would be highly desirable.

Recommendation No. 31:

Eliminate the provision for taxation of capital gains realized by a nonresident alien individual when he is physically present in the United States; extend from 90 to 180 days during a taxable year the time that a nonresident alien individual may spend in the United States before becoming subject to tax on all capital gains realized by him during such year.

Many foreign countries do not tax capital gains, and the threat of such taxation in the United States, therefore, deters investment in the United States by foreigners. In principle, the United States already exempts from taxation capital gains realized by nonresident alien individuals and foreign corporations not engaged in trade or business in the United States. But this exemption is limited by the imposition of a tax on capital gains realized when a foreign individual is present in the United States and by the imposition of tax on all capital gains realized by a foreigner in any year during which he is present in the United States for 90 days or more. These limitations are sufficiently stringent and, in the case of the physical presence test, sufficiently illogical that they impair the basic concept that capital gains of nonresident alien investors are exempt from U.S. taxation. It is our understanding that the revenues stemming from capital gains taxation imposed as a result of these limitations are small.

The physical presence test would appear to have no practical justification and, although easily avoided, it poses a potential trap for the unwary, unsophisticated or uninformed investor. As such, it contributes to the feeling among foreign investors that investment in the United States is complicated and potentially hazardous from a tax standpoint. The 90-day test is, in our opinion, too short a period.

Eliminating the physical presence test entirely and extending the 90-day period to 180 days would, we believe, remove most of the present unfavorable impact of potential capital gains taxation.

Recommendation No. 32:

Provide that a nonresident alien individual engaged in trade or business within the United States be taxed at regular rates only on income connected with such trade or business.

There is obvious justification for taxing nonresident alien individuals at regular rates on earnings from a trade or business conducted within the United States. However, the logic of extending such taxation to the investment income of foreign investors is open to question. This provision certainly deters foreign businessmen operating in the United States from becoming investors in the United States, and may also deter foreigners already investing in the United States from commencing a trade or business here.

The problem posed by the present system of taxation may be particularly acute in the case of foreign investors owning and operating real estate (or having it operated for them). Such investors are deemed engaged in a trade or business, even though the real estate activities may be more in the nature of an investment than a business. Real estate investors of this type are often large potential investors in securities. To the extent that an investor is engaged in one of these two activities, he is to a great degree precluded from engaging in the other.

We recognize the administrative complications the Internal Revenue Service would face in segregating a foreign investor's activities along the lines discussed above. But we believe that this is an important part of the package of recommendations for attracting additional foreign investment and that an attempt should be made to resolve these difficulties.

Recommendation No. 33:

Amend the definition of personal holding companies appearing in the Internal Revenue Code so that foreign corporations owned entirely by nonresident alien individuals are excluded from the definition.

The penalty provisions of the personal holding company tax were designed to prevent the use of holding corporations as a device to escape the graduated tax rates applicable to individuals. Elimination of progressive taxation on the nonbusiness income of nonresident alien individuals, therefore, would remove a basic reason for imposing penalty taxes on personal holding companies entirely owned by nonresident aliens. Such corporations are currently excluded from the definition of personal holding companies if less than 50 percent of their gross income is derived from U.S. sources. If the exclusion were broadened, as we have recommended, this would remove the substantial incentive existing under current law to limit the portion of such corporations' assets which is invested in the United States. This change would have no effect on the taxation of personal holding companies having U.S. shareholders.

Recommendation No. 34:

Clarify the definitions of engaging in trade or business to make it clear: (i) that a nonresident alien individual or foreign corporation investing in the United States will not be deemed engaged in trade or business because of activity in an investment account or by granting a discretionary investment power to a U.S. banker, broker, or adviser; and (ii) that a nonresident alien individual or foreign corporation will not be deemed engaged in trade or business by reason of the mere ownership of real property, by reason of a strict net lease, or by reason of an agent's activity in connection with the selection of real estate investments in the United States.

There is a general feeling of confusion among foreign investors over the application to investment activities of the tests for engaging in trade or business. This confusion certainly fosters a fear among foreign investors that they may through inadvertence be deemed to have engaged in trade or business and thereby become subject to regular U.S. taxation on their income and gains. These fears, whether or not realistic, unquestionably are a deterrent to foreign investment in this country.

Clarification of three major points through the issuance of regulations or rulings would aid materially in eliminating the existing confusion and fears. One would be to make it clear that the degree of activity in a securities account is not a factor in determining

whether or not a nonresident alien individual or foreign corporation is engaged in trade or business in the United States.

The second would be to affirm that the granting by a nonresident alien individual or a foreign corporation of a discretionary power for the purchase and sale of securities to a U.S. banker, broker, or adviser does not constitute engaging in trade or business in the United States.

Third, under present law, many advisers feel that any ownership of real property by foreign investors creates a question of doing business. Clarification of this question should have a favorable effect on the amount of real estate investments made by foreign investors in the United States and probably also on the amount of security investments made by foreign investors desiring to own both real estate and stocks.

Implementation

Basic to our recommendations is the belief that any steps taken must be unilateral moves by the United States. Negotiation of reciprocal tax treaties typically extends over many years and results in separate rules for each treaty country. To attempt to implement our recommendations through treaty negotiation would vitiate the possibility of their having an immediate impact on the balance of payments. Decisive unilateral action is necessary to preserve the package concept which is essential if our recommendations are to have their maximum favorable impact on investor psychology throughout the world.

We do not believe it sound to defer changes in U.S. taxation of foreign investors on the grounds that there still exist restrictions on the ability of U.S. securities firms to market the securities of U.S. corporations abroad. Although such restrictions do exist, many important industrialized countries do not prevent their residents from purchasing U.S. securities through one channel or another. Thus there are substantial sums of foreign capital that are susceptible to being attracted to the United States for investment, if the tax laws of this country are amended to make such investment more attractive. In fact, the existence of other restrictions on the flow of foreign investment to the United States and the time needed to have these restrictions removed are strong arguments in favor of making unilateral changes in our tax laws. These changes can be made with a minimum of delay.

Conclusion

Our recommendations for tax revision, if adopted as a package, would greatly simplify the entire question of U.S. taxation of foreign investors. Adoption of our recommendations would remove the substantial deterrent to foreign investment in the United States posed by a certain unwillingness among potential foreign investors to undertake complicated procedures for minimizing U.S. taxes. These procedures are often necessary if the investor is to avoid tax burdens which limit the attractiveness of investment in the United States. Complexities of the current system of U.S. taxation of foreign investors discourage these investors and advisers who endeavor to live within the confines of the law and good conscience. These complexities result in minuscule tax revenue, substantially reduce the incentive to invest here and encourage disrespect for our laws.

Reducing Restraints on the Sale of U.S. Securities in Other Capital Markets

The monetary disturbances of the 1930's, followed by World War II and the abnormal needs and circumstances of reconstruction, left Europe and most other advanced areas of the world with relatively small and inefficient capital markets. These markets were separated from each other and from the remainder of the world by numerous monetary, legal, administrative, and institutional restrictions. Much progress has been made in recent years toward removing controls on the movement of capital between industrial countries and toward improving the internal functioning of their capital markets. Nevertheless, restrictions still impede foreign purchases of U.S securities and limit the ability of U.S. firms to obtain long-term financing for their oversea operations from foreign sources.

Although the Task Force has conducted an intensive study of restrictions in other capital markets, we have not attempted to set forth all of our findings here. The identification and critical appraisal of restrictions remaining in the capital markets of other industrial countries have been covered extensively in a recent study by the Treasury Department, made publicly available by the Joint Economic Committee of Congress. In this section of our report, we summarize the most important legal and administrative obstacles abroad which impede foreign investment in U.S. corporate securities. No useful purposes would, we believe, be served by making detailed recommendations as to the removal of foreign restrictions or methods by which other countries could improve their domestic capital markets. In each country these matters are often complex and technical; they involve delicate domestic relationships; frequently they transcend financial considerations and encompass national policies well beyond the terms of reference of the Task Force. It should be noted that efforts to remove restraining

influences on sales of U.S. securities to foreigners will raise in foreign financial markets the question of the continuance of the U.S. interest equalization tax as a factor affecting the sales of foreign securities to U.S. citizens, however temporary and special its basis.

Exchange Controls

Recommendation No. 35:

The Department of State and the Treasury Department should take bilateral diplomatic action aimed at securing the step-by-step removal of remaining exchange controls on capital transactions between advanced capital-forming countries and the discontinuance or liberalization of special exchange markets or procedures for investment transactions.

Substantial progress has been made in removing exchange controls, yet the situation is still far from satisfactory. Only the United States, Canada, Germany and Switzerland are free of exchange controls. Although adopting the aim of full liberalization, France, Italy, the Benelux countries and Austria have preserved certain restrictions. A third group of countries, which includes the United Kingdom, Ireland, Japan, Australia, Spain and the Scandinavian countries, retain a wide range of controls for balance of payments and monetary policy reasons.

The impact of exchange controls varies according to the operations regulated. In general, treatment of direct investment is the most liberal; the treatment of financial loans (that is, loans not linked to commercial transactions) is the least liberal. Treatment of portfolio investment has been formally "liberalized" in Austria and the Common Market countries, but even some of these countries retain practices which tend to be restrictive.

In some countries, for example, foreign securities may be purchased only through authorized banks. In some cases, certificates of ownership of foreign securities must be kept on deposit at these banks; in other cases purchases of foreign securities which are not listed on securities exchanges sometimes require the prior approval of exchange control authorities.

Japan, Australia, Spain, Ireland and the Scandinavian countries all exercise tight control over foreign portfolio investments; except in rare instances, their nationals are not permitted to buy foreign securities. Although residents of the United Kingdom may freely acquire foreign listed securities and certain U.S. over-the-counter securities, they can do so only with funds obtained from the limited pool of "investment dollars" which now sell at a premium of about 11 percent, after having been as high as 14 percent earlier in 1964. These "investment dollars" represent primarily the proceeds of sales for dollars or other foreign currencies, of foreign securities held by United Kingdom residents.

Capital Issues Control

Recommendation No. 36:

The Department of State and the Treasury Department should encourage and support the enlargement of free world capital markets and urge countries with balance of payments surpluses to relax their capital issues control in order to permit an expanded volume of international lending.

New issues of foreign securities are carefully controlled in most major countries. The liberalization of capital issues raises sensitive questions because sales of new securities issues have a direct impact on interest rates, patterns of investment and the balance of payments. Some countries restrict distributions of foreign securities in attempts to prevent heavy demand for capital by foreign borrowers from driving up domestic interest rates and siphoning off a high proportion of domestic savings. In some countries direct controls over securities issues are in part designed to channel financial resources into investments considered of high priority by the government concerned. Although there has been some recent relaxation with respect to foreign borrowing in the United Kingdom, the capital issues control policy of that country generally has been to reserve the London new issues market for sterling securities for residents of the sterling area and the European Free Trade Area.

Regulation of Institutional Investors

Recommendation No. 37:

The Department of State and the Treasury Department should request that the Organization of Economic Cooperation and Development (OECD) initiate a comprehensive review of the practices and regulations in member countries relating to investment portfolios of financial institutions.

Regulations governing the investment portfolios of institutions such as commercial banks, insurance companies, savings banks, investment companies and pension funds—while principally designed to protect depositors, shareholders, or policyholders—often tend in practice to create protected markets for certain privileged borrowers and to restrict foreign investment. Foreign securities, even when denominated in domestic currencies or protected against exchange risks, are usually discriminated against by regulatory authorities. Offerings of new or secondary issues of foreign securities in particular are much more difficult to market abroad when certain large institutional investors are not allowed to subscribe.

Financial institutions in most countries have gradually been permitted to increase the proportion of their assets held in equities. The risk involved in holding good-quality foreign securities would, in many cases, be no greater than the risk involved in investing in many domestic securities. We believe serious consideration should be given to relaxing restrictions on the amount of securities denominated in foreign currencies that can be held by such institutions.

Role of International Organizations

Recommendation No. 38:

The Department of State and the Treasury Department should, through appropriate international bodies, particularly the OECD, advocate the step-by-step relaxation of monetary, legal, institutional, and administrative restrictions on capital movements, together with other actions designed to increase the breadth and efficiency of free world capital markets.

The international movement of capital is kept under constant review by the Organization for Economic Cooperation and Development, to which the United States belongs. This organization can and should be more intensively utilized as a forum for review and confrontation on restrictions impeding the flow of capital among its members. Similarly, the OECD can assist in developing more effective capital markets in countries where these markets have lagged behind rapid industrial growth.

Recommendation No. 39:

The Department of State and the Treasury Department should urge the International Monetary Fund to encourage step-by-step elimination of capital controls. The Fund should be requested to prepare a study dealing with remaining capital controls and how their elimination can encourage stabilizing movements of long-term capital and thus contribute to balanced international payments.

The International Monetary Fund can play an important role in eliminating restrictions on long-term capital movements associated with security purchases. Member countries are required to inform the Fund of capital restrictions they impose. Annual consultations of the Fund provide an opportunity for review and for comments by the U.S. Executive Director. Although the Fund cannot formally take exception to capital restrictions—since its approving jurisdiction is limited to restrictions on current transactions—it can indicate that removal of capital restrictions would be helpful to the international financial mechanism. The decision by the Fund in 1961 to make its resources available to finance balance-of-payments deficits arising from capital outflows should help encourage countries to eliminate capital controls.

V. Conclusion

Other industrial nations, especially those in Western Europe, have made impressive economic progress in the postwar period. This has been reflected in the growing volume of savings and the strengthened balance-of-payments position of most of these countries.

Moreover, the institutional framework for foreign portfolio investment in U.S. corporate securities has been strengthened in recent years. U.S. financial firms have a large and growing number of oversea branches and affiliates staffed with highly trained personnel. This, together with the current vigor of the U.S. economy, has created an environment favorable to increased sales abroad of the shares of U.S. corporations.

At the same time, many U.S. corporations have established themselves in industrial countries where capital markets are expanding; prospective investors in these countries can readily identify these corporations with products and services of internationally recognized quality. The framework for financing abroad these foreign operations of U.S. corporations has thus also been strengthened.

In our investigations, however, we have found a number of obstacles—both at home and abroad—which limit increased foreign investment in U.S. private companies. In this report, we have identified the more important of these restraints and have made recommendations which, in our opinion, could improve the U.S. balance-of-payments position in this area within a reasonable period of time. Concerted efforts in both the public and private sectors of our country are required if these recommendations are to prove effective.

U.S. corporations and financial firms are already making an important and growing contribution to our receipts from abroad. Because of our overall balance-of-payments problem, however, it is imperative that every effort be made to increase this contribution. To this end, our report has outlined a variety of actions in several areas. Collectively, these actions could yield impressive results.

We urge the U.S. financial community, U.S. industrial corporations, and the U.S. Government to give close and continuing attention to the problems and opportunities set forth in our report.

The increased freedom of capital movement and increased participation by foreign citizens and financial institutions in the ownership and financing of U.S. business will serve to strengthen the economic and political ties of the free world as well as its monetary system.

Therefore, we attach special importance to our recommendations concerning possible reduction or elimination of obstacles to the international flow of capital.

The work of the Task Force has, we feel, resulted in increased exchange of information in areas of potential cooperation between the financial community, industrial corporations, and public agencies. Our final recommendation is that this exchange of information and cooperation be continued.

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