

The Director

May 27, 1968

OBR (Reeve/Struve)

**A-65 and A-58 classification of the  
Trust Territory of the Pacific Islands**

Interior has requested that Circular No. A-65 be amended to move the Trust Territory of the Pacific Islands from the foreign category to "United States Territories and Areas." Such an amendment would require that Interior and other agencies, e.g., Peace Corps and Defense, exclude transactions with the Trust Territory from their reports under both Circulars No. A-65 and No. A-58. In addition, Treasury and Commerce would have to begin collecting data on the Trust Territory's balance of payments with the rest of the world and to include these data in the published U.S. balance of payments statistics.

Recommendation

The attached letter would deny Interior's request for a reclassification of the Trust Territory and withdraw their present A-58 exemption which allows Interior to exclude transactions with the Trust Territory from their submissions.

Background

Pursuant to your request, we have reviewed more fully several implications of Interior's proposal with various informed sources, including State (Legal Adviser), Interior (Territories) Commerce (OBE) and OSS (Bowman, Ryan). OSS also called a brief meeting of its Interagency Committee on Balance of Payments Statistics for this purpose.

Potential impact on Balance of Payments

We have tried to get information on the probable impact on our reported balance of payments from adopting Interior's proposal. The full picture is not available, but some indications are the following:

1. If the Trust Territory were classified as a U.S. Territory, then all our transactions with the Trust Territory would be excluded from the U.S. balance of payments and all of the Trust Territory's transactions with the "rest of the world" would be included in it.

(a) Based upon Commerce data for 1966 and 1967, U.S. exports and imports would be reduced by the following amounts of U.S. trade with the Trust Territory:

U.S. Trade with the Trust Territory  
(in millions of dollars)

<u>U.S.</u>	<u>1966</u>	<u>1967</u>
Exports	5.2	7.0
Imports	2.3	0.6

(b) According to the annual report of the U.S. High Commissioner, the Territory's worldwide exports and imports in 1966 were \$3.0 million and \$8.9 million, respectively. Thus, deducting our 1966 trade with the Territory from their worldwide trade, the Trust Territory's trade deficit with the rest of the world was \$3 million.

(c) Adding this deficit to the net reduction in U.S. trade (-\$2.9 million), the total impact in 1966 on the U.S. trade balance of including the Trust Territory would be -\$5.9 million.

2. On the other hand, present Interior grants to the Trust Territory (\$16.2 million in 1966 and \$14.4 million in 1967--rising to an estimated \$35.8 million in 1969) as well as any payments by other Federal agencies, would no longer directly affect our balance of payments, since they would become intra-area transfers, rather than overseas payments.

3. The main unknowns are the amount of the Territory's capital transactions with the rest of the world and the trade between the Trust Territory and the several U.S. territories and areas which are not covered by detailed Census data. Even with these uncertainties, however, it is quite likely that there would be some net improvement in the reported U.S. balance of payments if the Trust Territory was included.

Case for treating the Trust Territory as part of U.S.

Interior's basic argument is that treatment of the Trust Territory as part of the U.S. would be consistent with U.S. policies and with the actual financial situation of the Territory. State (Legal Adviser) on balance supports Interior on the grounds that "The Trust Territory, for purposes of transactions between it and the U.S., is more analogous to jurisdictions in your 'U.S. Territories and Areas' classification than your 'foreign' classification . . . ." and that "economic and administrative reasons seem to us to lead to the same conclusion . . . ."

1. Administration. Both departments emphasize this consideration.

a. In most respects, the Territory "is financed and administered in the same manner as one of the territories of the U.S." (Interior)

b. Under the UN Trusteeship Agreement, "the U.S. has, in effect, full powers of internal government and foreign relations responsibility over the Trust Territory subject only to general obligations to promote the political, economic, social and educational advancement of the inhabitants, to guarantee them basic freedoms, and to exercise power conformably with the U.N. Charter and the objectives of the trusteeship system." (State)

2. Laws. A number of U.S. laws have been extended to the Trust Territory; no concurrence by the U.N. is required. (Interior)

3. U.S. currency is the standard medium of exchange. (Interior and State). Comment. It is also the primary medium of exchange in the Ryukyus and Liberia, both of which are "foreign."

4. Postal system. The U.S. postal system has been extended to the Trust Territory (Interior). Comment. A matter of administrative convenience.

5. Regulation of investment. Under the Foreign Direct Investment regulations, the Trust Territory is treated as part of the U.S. Moreover, U.S. investment is the only investment permitted by non-residents. (State)

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### Case for treating Trust Territory as Foreign

OSS and its Committee on Balance of Payments Statistics--including representatives from Commerce, CEA, Federal Reserve, and Treasury strongly favor treatment of the Trust Territory as foreign for balance of payments and gold budget purposes.

1. Sovereignty. The U.S. does not assert sovereignty over the Trust Territory. Comment - State says this should be given little weight where it is not related to economic transactions.

2. Law. The Trust Territory is a "foreign country" under the Federal Tort Claims Act and under the Internal Revenue Code (by Tax Court decisions) for the purpose of excluding earned income from sources outside the U.S. from certain income taxation. (State)

3. Import and customs policies. The U.S. normally excludes treatment of the Trust Territory from the operation of most favored nation clauses in treaties of commerce and navigation. Custom duties are payable on imports from them, unlike the situation for our insular possessions. (State)

4. Foreign aid. (a) The funds which Congress appropriates to administer the Trust Territory are essentially special foreign assistance to a less developed country and, in our judgment, ought to be regarded as foreign aid.

(b) The Trust Territory is treated as a "lesser developed country" under the Interest Equalization Tax. (State)

5. Treatment in related statistical reports. The Trust Territory is treated as "foreign" in the most closely related statistical reports, including (a) Commerce trade and aid data, (b) Treasury foreign grants and credits data, (c) U.N. trade and aid data and (d) OECD-DAC aid data. "Much is to be gained by maintaining consistency of reporting under A-65, A-58 and the recently issued Treasury Circular No. 1080 dealing with the reporting of foreign grants, loans and credits." (OSS).

6. Precedent for other changes. Treatment of the Trust Territory as part of the U.S. for A-65 and A-58 reporting purposes could raise other controversial questions:

(a) It could encourage Defense to push for revision of the present treatment of the Ryukyus as foreign, where we now recognize that Japan has a "residual sovereignty." This could only aggravate problems with Japan.

(b) It might open a question on the validity of present classifications of U.S. international trade and aid data; and

(c) Absorption of the Trust Territory into our trade and financial statistics might give a pretense for charges of imperialism.

#### Staff Views

NRPD has "no strong feelings either way on this issue but believes that on balance BOB should concur in the recommendation of Interior and State." Their position was influenced by the following considerations:

(1) advantage to the U.S. balance of payments; (2) the practical similarity of the U.S.'s relationships with Guam, Samoa and the Trust Territory; and (3) in view of the desirability of assuring a favorable result in the future plebiscite, "there would be some small public relations value attached to treating this area as domestic for reporting purposes . . ."

OBR concurs with OSS and its interagency committee that the reclassification of the Territory for A-65 and A-58 purposes is not justified at the present time. At a minimum, the reclassification would add to the reporting workload for the statistical services, and open the door for more questions regarding our treatment of other areas. The public relations aspect of absorbing the Trust Territory seems more likely to be negative than positive. No improvement in our real balance of payments position would result from this change in reporting requirements. We, therefore, find no compelling argument for reclassifying the Territory for the purposes of balance of payments and gold budget statistics.

Attachment

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