

CAPITAL MOVEMENTS

Capital movements are movements of funds for investment for which no immediate quid pro quo, in the form of commodities or services, is received. They can be for either short- or long-term investment, the former being influenced largely by interest rates. Long-term investment is for the purpose of constructing or acquiring production facilities with a view to receiving income in the future. Investment can be either private or governmental. Private investment, in turn, can be either direct or portfolio. Direct U.S. foreign investment is the direct ownership of production facilities, either in whole or in part, in a foreign country by U.S. nationals. By portfolio investment is meant the purchase by Americans of securities issued by foreign companies.

Government investments are directly related to a country's foreign policy. Most outstanding U.S. Government foreign investment is a consequence of its foreign aid programs.

Capital investment by Americans abroad increases the outflow of dollars from the United States. The immediate effect on the balance of payments is similar to an increase of merchandise imports. The intermediate and long-run effects, however, are usually of greater significance than the short-run effects and serve to increase the inflow of dollars.

Shortly after investment funds flow abroad there is a tendency for some, or all, of the dollars to return to the United States to purchase American capital equipment and other exports. Sometimes the terms of the loan require that the dollar proceeds of the loan be spent in the United States. Such loans are known as "tied loans." Of course, eventually all U.S. dollars return to the United States, just as pounds sterling return to the United Kingdom and French francs return to France, since the money of any country is of value, ultimately, only in the country that issued it. In the case of direct foreign investment a large part of the loan proceeds usually flows back to the lending country fairly quickly.

In the long run, after the foreign investment has increased production in the recipient country, there is a tendency for dollars to flow back to the United States in the form of earnings on investment. This inward flow of dollars has a similar effect on the balance of payments as increased exports and, if continued over a considerable period of time, will necessitate increased dollar payments (just as a steady increase of exports would do) usually in the form of increased imports. Therefore, a country that engages in large-scale foreign investment over a long period of time must expect that eventually its merchandise imports will exceed its exports. This is because the investing country is receiving a return on its investment, the anticipation of which was the reason for investing the capital abroad in the first place. This was the situation in which the United Kingdom found itself in the latter part of the 19th century. Her persistent adverse balance of trade was a mark of her international economic strength.