

short-term claims on us; and lastly with the "errors and omissions" item in balance-of-payments statistics, an item which has been subject to a sharp adverse shift from a traditional "plus" to a substantial "minus" in the last 2 years, a shift which can, I believe, be shown to be linked to private capital movements. I am excluding consideration of direct investments from my testimony. It is possible that some of the substantial increase in direct investment outlays by American businesses abroad during the last few years has been motivated by high interest rates abroad and low rates in this country. A large proportion of what is "direct investment capital" involves simply changes in intercompany accounts, between the parent company in the United States and subsidiaries abroad. Faced with borrowing short-term capital abroad on the one hand, and borrowing it here or using existing cash here and directing it abroad through intercompany accounts on the other, a corporation may make its decision in part on the basis of interest-rate differentials. But it seems doubtful that the movement of any large magnitude of funds is in fact determined in this way; i.e., solely or even primarily by interest-rate considerations—if for no other reason than that foreign operations of most U.S. companies do not seem to be closely integrated with domestic operations.

I. INTEREST RATES AND LONG-TERM PORTFOLIO INVESTMENT

The basic components of recorded movements in long-term portfolio capital into and out of the United States over the last 10 years are shown in condensed form in table 2. Investment by U.S. residents in foreign stocks has been approximately matched throughout the decade 1952-61 by foreign investment in U.S. stocks. The substantial increase in recorded net portfolio outflow has been in bonds, not stocks, and while most of this has been in the form of increased new issues on the New York market, the demand for foreign bonds seems to have outrun the new supply coming to that market so that U.S. residents have been buying outstanding issues, presumably (but not necessarily) going to foreign capital markets to fill their needs.

It is interesting, and necessary if we are to consider interest rate motivation, to get some perspective on the regional distribution of these portfolio investments. Ninety percent of the U.S. outflow over the 5-year period 1957-61 has gone to regions other than Europe (unlike direct-investment outlays, 50 percent of which has been going to Europe). This 90 percent is split about equally between Canada and less-developed countries (counting that moving to such regions through international institutions). Perhaps more informative is the net movement of portfolio capital between the United States and other regions of the world. It is evident from the third part of table 3 that during the last 5 years the United States has supplied Canada with something over \$2 billion, largely through purchases of Canadian bonds, less-developed countries something under \$1 billion, and that one-third of this total \$3 billion outflow has been offset, or financed so to speak, by an inflow of long-term private capital from Europe.

The question arises as to how much of this substantial long-term portfolio investment of the last 5 years, which greatly exceeds that of the previous 5 years, is actually mobile capital—capital which can move in response to changes in interest rates, in share prices, in levels of economic activity, in tax policy, or whatever else may influence it. It would appear from study of the data that around \$1 to \$1.5 billion worth of increased U.S. security holdings by foreigners, and about the same amount of accumulations of foreign securities by U.S. residents, is potentially mobile capital—about half consisting of bonds, half of stocks.

Long-term interest rates in the United States have been consistently below long-term rates in Canada and in Europe during the last 5 years; the Canadian-United States differential has been relatively constant, but the United Kingdom-United States differential has varied from between one-half a percentage point to more than 2½ percentage points in the middle of last year. A high foreign and low U.S. rate, or an increasing differential might be expected to have two types of effects on long-term portfolio capital movements: (1) It might induce a larger amount of new issues of foreign securities here; (2) it might induce foreigners or U.S. residents to sell U.S. bonds and/or buy foreign bonds, i.e., the capital movements would be reflected in transactions in existing securities.

I have tried to investigate these possibilities by comparing bond purchases and relevant interest rates, using quarterly data of the last 5 years. The only rela-