

ing the period of substantial speculation against the dollar, evidently sparked by a fear that the United States might devalue, in late 1960 and early 1961.

The behavior of the group holding the second largest portion of liquid dollar assets—foreign commercial banks—follows a somewhat different pattern. It appears that banks steadily lowered the ratio of dollars to total foreign exchange reserves between 1956 and 1958, increased the ratio substantially again following convertibility (the increase comprising mostly increased holdings of European commercial banks), and dropped the ratio even more sharply than did central banks during the last quarter of 1961 and first quarter of 1962. The 10-percentage-point drop during this period implies a loss of around \$500 million in U.S. liquid liabilities; whether this in fact meant a gold loss of that amount depends upon what the recipient central authority, in the bank's own country or elsewhere, did about its increased foreign assets, that is, whether it decided to increase its gold stock, its dollar assets, or its exchange reserves in non-dollar currencies.

An aggregative approach to the switch problem can hide a multitude of sins. Perhaps reserves were simply moving from countries which do not hold the bulk of their reserves in dollars (sterling area countries, for example) to countries which do, and this movement was reversed toward the end of 1960 and in early 1961. In an attempt to scrutinize the switching problem more closely, I have analyzed the behavior of some 23 countries, tracing the relationship between the ratio of dollar assets to total foreign exchange reserves and the short-term interest rate in London and New York, and the relationship between this ratio, short-term interest rates, and total foreign exchange reserves of the country, using quarterly data for the period 1957–61. A few countries—Belgium, the Netherlands, Mexico, and Peru, for example—do seem to be responsive to interest rates here and in London, and build up and draw down exchange reserves in one center or the other accordingly (assuming that the residual foreign exchange not in dollar assets is in pounds sterling, although there is no way to know this for sure). But most countries seem either to maintain a relatively fixed ratio of dollar reserves to total foreign exchange reserves, or to alter this ratio in some regular and systematic fashion in accordance with the level of their total reserves.

There thus appears to have been only a small amount of switching of foreign exchange reserves around from one country to another—presumably primarily between London and New York—in response to movements in interest rates in recent years. As in the case of U.S. short-term claims, the fact that higher short-term rates prevailed abroad may have aided and abetted the speculative movement out of dollars in the fourth quarter of 1960 and first quarter of 1961, but it seems doubtful that interest rates caused the movement, *per se*. The short-term interest differential between London and New York was large on either side of this period of speculation, but relatively small during the period. Furthermore the spot price of sterling fell steadily from September of 1960 to May of 1961 so that people who switched funds suffered at least short-run losses.

IV. THE ERRORS AND OMISSIONS PROBLEM

Everything that I have said so far relates to recorded long- and short-term capital movements. One of the great problems for balance-of-payments analysts has to do not with what is recorded in the official statistics, but rather what is not recorded—with the residual item entered at the bottom of balance-of-payments tables which is termed “unrecorded transactions” or “errors and omissions.” Many people suspect that movements in this item represent short-term capital flows. There is a logical reason for this suspicion. The statistics for most balance-of-payments items are collected for flows during a period. But the statistics on which short-term capital movements data are based are stocks at the end of a month, and the flow is measured by the change in the stock outstanding from month to month. Suppose deposits payable in foreign currency, either of banks or of nonfinancial corporations, rise from the end of one quarter to the end of the next, then are lower at the end of the following quarter. The statistics report that there was a short-term capital outflow during the first quarter, an inflow during the second quarter, as if the funds came back to this country. But there would seem to be no real reason to believe this to be the case; the foreign deposits may well have turned into another kind of foreign asset. If the deposit was used to buy out a foreign firm, and the U.S. firm making the purchase was one of those reporting to the Commerce Department on its direct