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CAPITAL MOVEMENTS FROM ABROAD

Movement of capital from abroad (1) results in an inflow of gold that complicates our credit problem; (2) gives us a sterile asset in the form of gold in return for assets sold to the foreigners that not only produce earnings but also may increase in value, and (3) puts us into a more vulnerable position by increasing the amount of funds that foreigners can withdraw on demand.

As far as we can anticipate we are not likely to have difficulty in any predictable future in offsetting the effects of gold withdrawals on the reserve position of member banks. It may be more difficult, however, to counteract the effect of a possible further dumping of securities by foreigners on the value of securities held by investors.

According to the best estimates that we can get, foreigners hold about $7,000,000,000 of all kinds of funds in this country, including securities and short-term balances. Of this amount perhaps about $5,500,000,000 are long-term investments of which $1,500,000,000 represent investments in subsidiaries or other forms of property which could not readily be realized. Of the securities held by foreigners, probably $4,000,000,000 to $4,500,000,000 represent holdings acquired before the depression and $1,000,000,000 to $1,500,000,000 represent more recent acquisitions. The profits earned by foreigners holding securities that they have acquired since 1932 is probably not more than $500,000,000 and the rise in the value of securities held prior to that time may be another $2,500,000,000. Securities acquired prior to 1932, however, were bought originally at varying price levels and many, particularly those purchased in 1928 and 1929 at higher prices than the present market.

To tax now all profits made on securities held by foreigners made since 1932 would undoubtedly have the desirable effect of discouraging the movement of capital to this country. But there are two or three objections to such a course of action: (1) it would look like bad faith and create a lot of bad feeling because it would appear to be in the nature of retroactively changing the rules of the game. (2) It might result in wholesale withdrawals while the law was being debated. (3) It would be related to past movements which have already occurred rather than to new movements from now on. It would seem to be more practicable on general grounds as a means for discouranging foreign capital from coming here to tax all future capital gains by foreigners taking the present level of prices as a base. Such a course would not result in wholesale withdrawals at this time, because it would not affect profits already earned, but it would discourage further capital inflow and gold imports.

From the point of view of the exchanges, it would be a constructive move to discourage the movement of capital to this country, because it would relieve many of the foreign exchanges from the additional pressure exerted by capital emigration. From the American point of view it would have the advantage of removing a force toward appreciation of the dollar.

With our balance of international payments in its present condition the movement of capital to this country is bound to result in gold imports. Gold imports, in turn, add to our deposits and to our reserves, and gold exports will have to come out of our deposits and out of reserves. In this respect foreign purchases of securities are different from domestic purchases which do not of themselves create deposits or reserves. It may be added, however, that from present indications the anticipation is that there will be no large gold movements in either direction in the near future. Such a statement, of course, is hazardous because there are a number of unknown factors. If things continue here and abroad approximately along the present course of developments, it is probable that some continued inflow of foreign capital for investment will take place, but that it will be offset by gradual withdrawal of short-term balances so that it will not result in a large volume of gold imports.

It is obvious that a tax on foreign capital gains would involve many administrative difficulties and would be subject to evasion. Careful study both of the practical method of achieving the result and of the implications of such a tax policy itself would seem to be desirable.