economic review

JANUARY 1964

IN THIS ISSUE

FEDERAL RESERVE BANK OF CLEVELAND

Additional copies of the ECONOMIC REVIEW may be obtained from the Research Department, Federal Reserve Bank of Cleveland, Cleveland, Ohio 44101. Permission is granted to reproduce any material in this publication.

FOREIGN CAPITAL BORROWING IN THE UNITED STATES

IT IS widely recognized that many different factors have contributed to the U. S. balance of payments problem. Recently, attention has been devoted to the capital flows portion of the U. S. international accounts. During the first half of 1963, a marked increase in the outflow of long-term capital from this country was one of the principal causes of a redeterioration in the U. S. payments balance. The outflow of capital occurred mainly in the form of indirect investment, i.e., U. S. investment in foreign securities, as opposed to direct foreign investment by U. S. business firms.

The purpose of this article is to present the findings of a study of U. S. indirect foreign investment during the period 1958-1963. This study was conducted by the Research Department of the Federal Reserve Bank of Cleveland. The data for the study were obtained from announcements of individual issues of foreign securities published in financial newspapers and other sources in

Source of data: Federal Reserve Bank of Cleveland the six-year period from 1958 through 1963.[1] Term loans by banks, and new issues of bonds and stocks were included; secondary offerings or offerings of rights and warrants to existing stockholders were excluded.[2] Issues totaling less than $500,000 were excluded. Financing by foreign subsidiaries of U. S. companies and by international organizations such as the World Bank was also excluded. Because of these constraints on the data, it is difficult to compare dollar volumes in this study with statistics presented by other sources. (A forthcoming article will deal with the terms of borrowing, i.e., interest rates and maturities.)

BORROWING AT NEW HIGH

Foreign businesses and governments raised approximately $1.3 billion in the United States in 1963. This amount was roughly $50 million more than acquired in 1962 and was a record for any year since World War II. The bulk of the 1963 financing was concentrated in the first eight months of the year, producing an unfavorable impact on the balance of payments as noted earlier.

Foreign demand for U. S. long-term capital has been very large in the past two years. In none of the previous postwar years did foreign borrowing covered by this study reach one billion dollars. This does not mean that foreign use of U. S. capital markets was nominal in earlier years or that the outflow of funds has been increasing gradually since 1946. To the contrary, balance of payments figures on foreign borrowing published by the Department of Commerce show that each advance reached a successively higher level during the postwar period.

This study covers the period beginning with the most recent high (1958-59) through 1963. Because no clear trend is apparent in the grand totals, further details must be studied to explain recent patterns in foreign borrowing.

STAGE OF ECONOMIC DEVELOPMENT

The foreign countries that borrowed in the United States in the 1958-63 period have been sub-classified in several ways, one of which is the stage of economic development of each nation. In general, the classification determined by the Secretariat of the United Nations is used, with the arbitrary addition of a separate grouping of countries whose well-established economies are based on agriculture or natural resources rather than industry. These particular nations have the resources for greater economic growth, but already have achieved fairly high standards of living. Thus the three classifications used

[1] There were several problems encountered in collecting data for the study. For example, some foreign borrowing operations are not reported in the press and thus are missing from the data included here. This is particularly true for private placements of debt issues and for the actual sale of registered common stocks. Secondly, newspaper accounts may have been subject to typographical errors, resulting in incorrect data being reported. Finally, all details were not available for each reported issue: e.g., pertinent interest rates sometimes were not mentioned in the published accounts. It is believed, however, that the data that were compiled comprise a large proportion of foreign capital borrowing. In all cases, data for 1962 and 1963 are much more complete and accurate than for earlier years.

[2] Throughout this article, the terms "borrowing" and "capital" are used in the broad sense of acquiring all types of funds, rather than being limited to funds raised through the sale of bonds or debentures.

here are: industrially developed nations, such as Japan and Switzerland; "agriculturally developed" nations, such as Canada and Denmark; and under-developed countries, such as Brazil and India. Most of the countries in the world today fall within the under-developed class.

In 1963, seventeen nations raised new capital in the United States.[3] Five of these are classified as industrial economies, five as under-developed, and the remaining seven countries belong to the agricultural group.[4] The under-developed nations accounted for 17 percent of the dollar volume of the new capital issues (excluding the large total of new Canadian issues that tended to obscure the dollar volume of borrowing by other countries); the "agricultural" countries, 35 percent; and the industrial nations, nearly 48 percent. Were these proportions of total borrowing typical of the past six years? It is hard to discern a definite pattern because of sharp yearly fluctuations in the percentages for the different economic groups. Nevertheless, based on an average of the proportions borrowed in the past 6 years, borrowing by under-developed countries has been less than average since 1960, and borrowing by the agricultural group was somewhat below average in 1963. On the other hand, the volume of new capital raised in the U. S. by industrial nations has been above average since 1960. The relative proportions appear in Table I.

Table I
Foreign Borrowing in U. S.*
by stage of economic development of borrowing country
(Percent Distribution)

Year	Industrial Nations	Agricultural Nations	Under-developed Nations	Total
1958	12.3%	69.5%	18.2%	100.0%
1959	67.1	14.6	18.3	100.0
1960	28.2	29.2	42.6	100.0
1961	52.1	36.3	11.6	100.0
1962	44.0	37.6	18.4	100.0
1963	47.8	34.9	17.3	100.0

* Excludes all borrowing by Canada and $300 million bond issue of State of Israel in 1959.

Source: Federal Reserve Bank of Cleveland.

In regard to dollar volume of borrowing, total new issues of each of the three economic groups were relatively large in 1962 and 1963. In fact, new capital raised by industrially developed nations reached a 6-year high of almost $250 million in 1963. The table shows that under-developed countries have received a relatively small share of total capital funds borrowed in the U. S. If the more developed nations continue to absorb the largest share of available capital, under-developed nations may find increasing difficulty acquiring funds in U. S. capital markets.

The nature of the economic development of a foreign nation also affects its trading patterns with the United States. In turn, the vol-

[3] The phrase "new capital" may be taken literally. Of the dollar volume of foreign issues for which a purpose was given in published reports, less than 10 percent represented refunding of existing debt in 5 of the 6 years studied. The proportions in individual years ranged from 11 percent of dollar volume in 1961 to less than 1 percent in 1958.

[4] The industrially developed nations included France, West Germany, Italy, Japan, and Great Britain. The under-developed nations were Israel, Jamaica, Mauritania, Mexico, and Panama. The remaining countries were Australia, Austria, Canada, Denmark, Finland, Norway, and South Africa.

ume of trade with the U. S. is a major determinant of the need for dollars by foreign countries. The countries that borrowed here between 1958 and 1963 were ranked by the dollar volume of their net imports (gross imports minus exports) from the U. S. in 1958-62. It is interesting to note that Canada, the largest borrower in 1958-63, was also the largest net importer. A similar relationship of substantial supplies of capital raised here and substantial net imports was true for Mexico, Japan, and Italy. At the same time, however, other nations having a large trade deficit with the U. S. have not turned to this country as a source of capital funds. This is true for the Netherlands, India, Argentina, and West Germany.

EFFECTS OF ECONOMIC UNION

The dollar volume of foreign borrowing in the United States has risen to new highs since the previous high was reached in 1958. Two important developments occurred in that year. The establishment of convertible currencies in western Europe facilitated the flow of funds throughout the world and encouraged the use of capital markets of other countries. Another major economic event of 1958 was the establishment of the European Economic Community (the Common Market). The organization of customs unions or other forms of economic union usually results in substantial economic growth for the member nations. Does this growth, or potential growth, also result in a demand for capital funds that exceeds domestic sources?

In an attempt to find an answer, the borrowing countries included in this study were grouped according to their membership in an economic union. Here again, borrowing by both Canada and Israel was excluded to prevent obscuring the borrowing by other countries. The resulting pattern is rather surprising, in that the increase in foreign borrowing in the U. S. has been more significant among nations *not* belonging to economic organizations. Capital borrowing in the U. S. by such nations rose in each year beginning in 1960 and reached almost $300 million in 1963, or more than four times the dollar volume of 1959. The 1963 total was apparently a record amount.

In comparison, borrowing by nations belonging to an economic union rose sharply in 1959, declined just as sharply in the succeeding two years, rose to a peak of $260 million in 1962, and then subsided last year. Thus, membership in an economic union does not seem to be an important variable in determining whether a foreign nation borrows in the United States.

Since the latter group includes members of the EEC and the European Free Trade Association (established in 1959), it is possible that the organization of such unions produced an early but not sustained rise in borrowing in the United States. The large volume of new issues floated by member countries in 1962-63 is less easily explained. Economic growth had leveled off somewhat in western Europe by then, and the countries in that area were working to channel more efficiently the enlarged streams of domestic savings into local industry.

Since the economic bases of the two European customs unions are different, it is necessary to analyze their patterns of borrowing in the U. S. separately.[5] In 1958, borrowing by EEC countries appears to have been confined to one issue of $15 million by the City of Amsterdam. In 1959, however, four Common Market nations sold a total of $177 million in capital issues in the United States; this was the largest annual volume for this group in the six-year period under review. There was virtually no borrowing by the group in 1960, and only a moderate amount in 1961. The following year new issues exceeded the $100-million level, followed by a decline of more than 50 percent in 1963. The drop in 1963 may have resulted from U. S. efforts to shift some of the international financing burdens to the strong-currency countries of Europe.

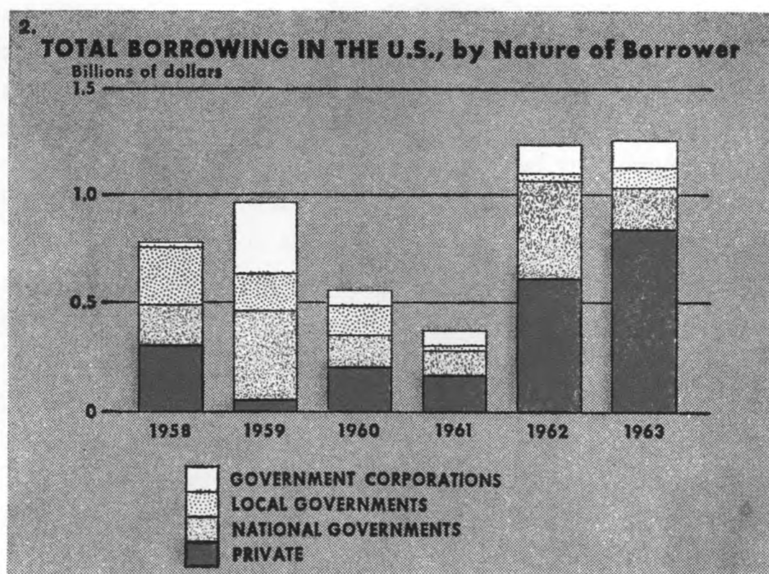
Of the five Common Market countries that borrowed in the United States in 1958-63, there is little indication of an increased reliance on the U. S. capital markets. In fact, the trends in both France and the Netherlands were in a downward direction. In the case of the EFTA, however, the volume of funds borrowed here by Norway, Denmark, and to a lesser extent, Portugal, show a definite rise. (As is discussed later, three remaining members of the EFTA—Great Britain, Switzerland, and Sweden—have established, but small, capital markets of their own.) Borrowing by the EFTA in the U. S. rose to new highs in 1962 and 1963, exceeding $100 million in both years.

[5] The nations belonging to the Common Market are for the most part highly industrialized and heavily populated, whereas the EFTA is comprised of nations with differing economies and population patterns.

NATURE OF BORROWER

In light of the fact that much of the foreign capital raised in the United States has gone to nations with established or well-developed economies, it is also important to identify the nature of the borrowers. The basic classification used here is that between private groups or organizations and public borrowing authorities. In addition, public borrowing is subdivided into new issues sold by national governments, local governments, and government corporations. (The latter organizations represent government-operated businesses and financial enterprises.)

Private borrowing has accounted for an increasingly larger share of foreign borrow-

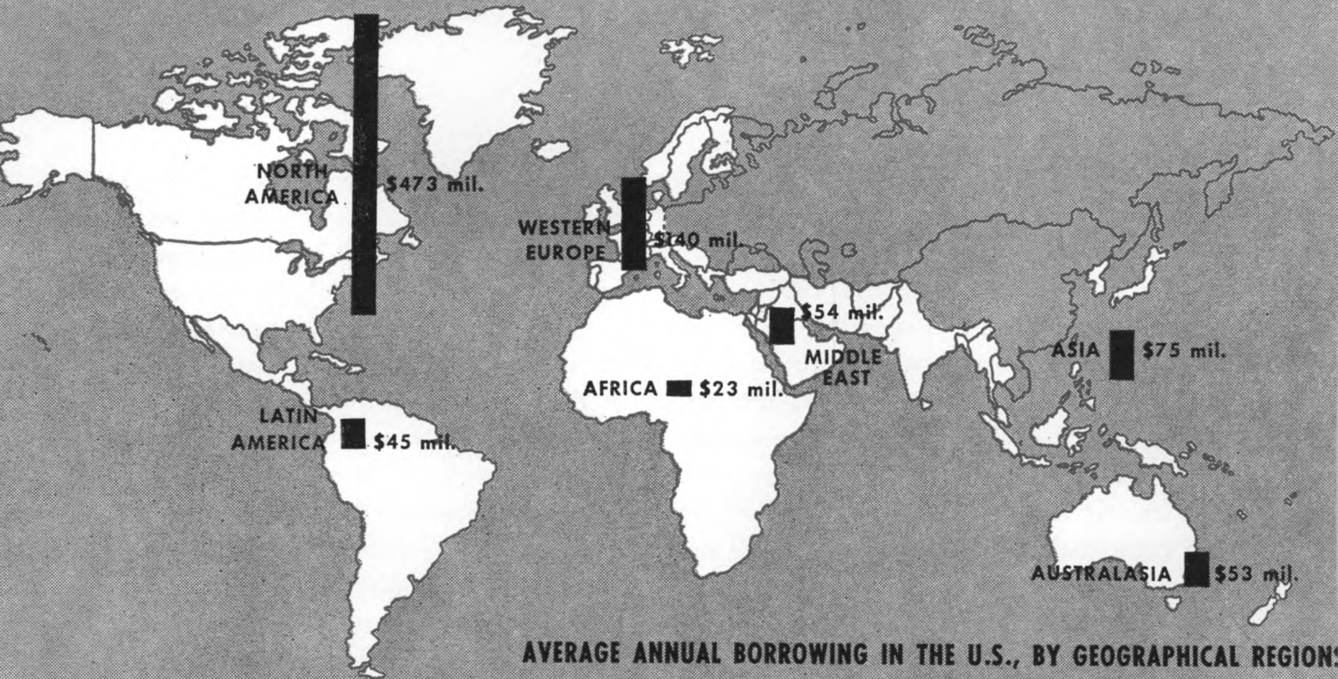


Source of data: Federal Reserve Bank of Cleveland ing in the U. S. since 1959. Last year two-thirds of the total dollar volume of new foreign capital issues sold in the U. S. (including Canadian issues) were sold by private organizations. This was a record high for the six-year period under review and was 20 percent larger than the previous high in 1962. This development may be the result of several factors. It reflects, in part, the establishment of convertible currencies in most of the major countries of the world in 1958, as well as the successful recovery of the private sector of foreign economies from the effects of World War II. The growth in private borrowing also results, in part, from the tendency of developed nations to account for the largest share of foreign capital raised in this country, while newly emerging economies are characterized more by a system of government enterprises. The rise in foreign private borrowing may have influenced the Administration's decision in July 1963 to ask Congress to adopt an interest equalization tax on foreign securities sold in the U. S.

The rise in the proportion of private borrowing, of course, has been accompanied by a corresponding decline in the share of new public or governmental issues. The trends in proportions in the period covered by this study are not easy to identify because of the coincidence of several unusually large issues in 1959 and 1962. Nevertheless, the data show that the relative share of new capital issues of national governments dropped to a 6-year low in 1963 (15 percent, compared with a high of 42 percent in 1959), that borrowing by governmental corporations has been declining slightly for several years, and that borrowing by local governments was much smaller in 1961-63 as a whole than in 1958-60.

This conclusion is supported by another classification that was made from the study data. There was occasional reference to proposed uses of the borrowed funds in the news reports that formed the raw material for this project. It was possible to separate out five general uses of capital funds and to compare the volume of funds designated for these uses in the past 6 years. Of these general uses of funds, at least three represent areas in which a large degree of government control or ownership is characteristic. That is to say, the public control and operation of utilities, financial institutions, and transportation companies are quite common in many countries. The other uses of funds—trade and manufacturing—are less apt to be public enterprises.

The dollar volume of funds channeled to foreign manufacturers rose above the $100 million level in both 1962 and 1963. In addition, the amount raised by trade concerns, while still relatively small, reached a 6-year high in 1963. All this would indicate a growing participation of private groups in foreign borrowing in the U. S. On the other hand, the volume of funds raised by foreign financial institutions rose to a new high last year, and foreign-based public utilities also increased their use of U. S. capital markets, raising a record total of more than $500 million in 1963. Only the transportation industry showed a decline, with the dollar volume decreasing since 1960.



AVERAGE ANNUAL BORROWING IN THE U.S., BY GEOGRAPHICAL REGIONS
1958-1963

GEOGRAPHICAL DISTRIBUTION

No single factor stands out as the principal determinant of the foreign demand for U. S. funds, nor can any single homogeneous group be shown to be responsible for the increase in borrowing. Furthermore, some nations are noticeably absent from U. S. capital markets. It is necessary, therefore, to examine some individual cases to ascertain what reasons have motivated specific countries to borrow in the United States.

North America. The accompanying map depicts the volume of new foreign issues by geographical location of the borrowers. The most obvious fact is that a great part of the foreign borrowing in the U. S. is done by countries or organizations located in North America.[6] Nearly all of the borrowing by this sector of the world is accounted for by Canada, with a very small proportion going to Caribbean nations and colonies.[7]

There is a long history of economic unity between Canada and the United States, with both nations sharing a similar geography and culture. Political stability and close linkage of financial markets of the two nations has also increased the acceptance of Canadian securities among U. S. investors, particularly institutional investors. In fact, the United States has provided such a ready supply of capital to Canada that recently there has been some objection in Canada to the proportion of U. S. control of Canadian industry.

In the six-year period under review, Canadian governments and businesses sold an

---

[6] For the purposes of this study, Mexico was included in Latin America.

[7] These are primarily Bermuda and Jamaica, although their dollar volume of funds borrowed has been declining since 1961. For a while, there was a tendency to use these areas as tax havens for U. S. funds, but recent changes in the Internal Revenue Code have discouraged this practice.

average of $475 million in new issues in this country annually. The years of heaviest borrowing were 1958, with more than $500 million raised, and 1962 and 1963, when over $700 million in new securities were sold in each year. The wide acceptance of Canadian securities by U. S. investors is illustrated by the fact that small companies and even school districts have borrowed in this country. Particularly large issues have been sold by the provincial governments, by some of the large metropolitan cities such as Montreal, and by governmental agencies and corporations. Examples of the latter group include power commissions and highway authorities. As a matter of fact, one-third of the total new issues sold by Canada in 1958-63 provided new capital for public utilities and transportation agencies.

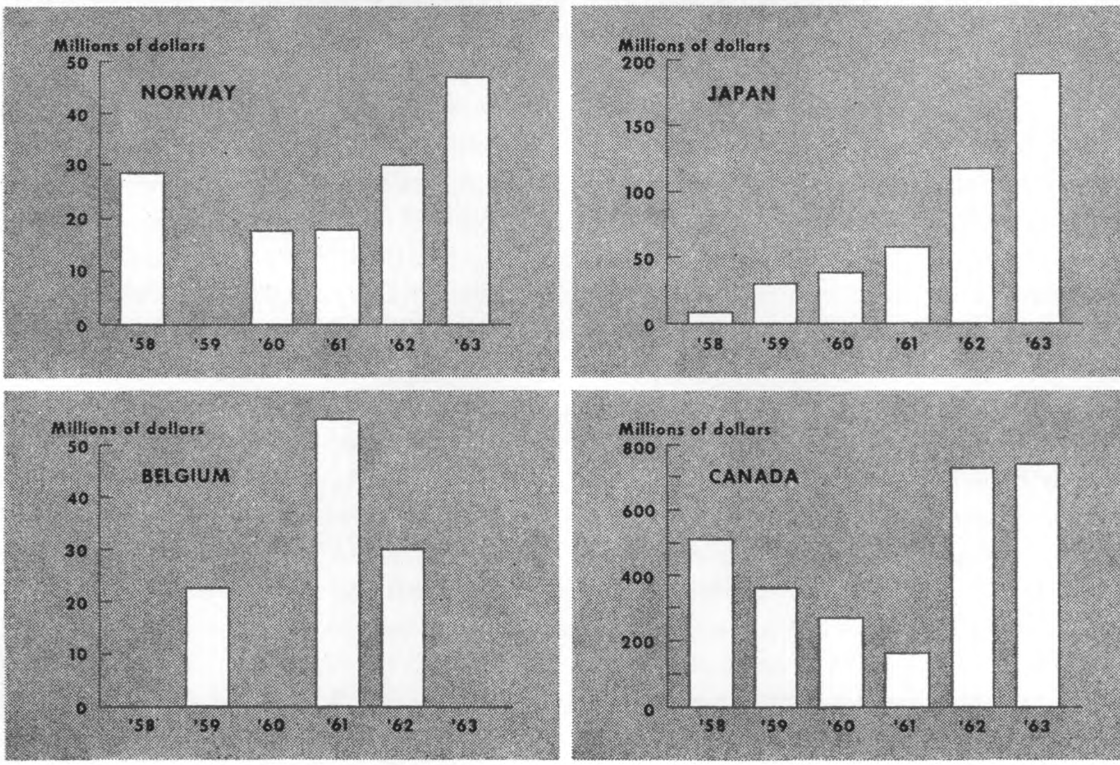
Canada is not a member of an economic union, unless one could ascribe some of the characteristics of such a union to the British Commonwealth. Nevertheless, Canada is still in the process of expanding its economic base, often by opening unsettled areas for the development of natural resources. New capital for such development usually is obtained and disbursed by public authorities. Heavy industry is important only in some of the larger metropolitan areas. Thus, it is not surprising that Canadian manufacturers accounted for only 8 per cent of that country's total borrowing in the U. S. since 1958.

Although Canada has a relatively high per capita income, the supply of savings is not large enough to meet all of the country's capital needs. Canada also has a large social insurance program, on both a national and a provincial level. For example, all citizens over the age of 70 receive a federal old age pension regardless of their previous employment or income level. It has been suggested that the existence of such social insurance tends to reduce the amount of private, voluntary savings in the nation. Whatever the cause of the insufficiency of investment funds, Canada has turned to the United States for a considerable part of its capital.

It had been widely assumed that the Canadian reliance on borrowing in this country was due to the availability of funds in U. S. markets. The concern in Canada over the proposed interest equalization tax, however, indicated that the costs of raising new capital are also an important factor. (Canada was granted a special exemption from the proposed tax in August 1963.)

Western Europe. Borrowing in the United States by European nations has been confined to those in the Western Alliance. European borrowing was described earlier on the basis of membership in the two economic unions in that geographical area. It is apparent that dependence on U. S. capital has declined in several European countries. Because France has raised objections to any increase in U. S. ownership of French industry, it has moved to expand the scope and operation of its own capital market by making it easier for individuals to invest their savings in the private economy. Heretofore, the French have preferred to place their savings in time deposits or government securities. Only one adult in every 30 in France owns stock, in contrast to one in seven in the U. S. Now the establishment of mutual funds and building societies has been authorized by the French government.

4. BORROWING IN THE U.S., by Selected Countries



Source of data: Federal Reserve Bank of Cleveland

NOTE: The study did not reveal any borrowing in the U. S. by Norway in 1959 or by Belgium in 1958 and 1960

The other European nations whose borrowing in the United States has declined have a financial market structure that corresponds more closely with that in the United States. Belgium is an illustration of such a nation whose borrowing in the U. S. has declined—the Netherlands, Austria, and to a lesser extent, Great Britain and Switzerland also serve as examples. In the period covered by this study, four Belgian financing operations in the U. S. were reported, totaling $107.5 million. In each case, the funds were borrowed by the national government. Chart 4 shows that Belgium raised funds in 1959, the year following the organization of the Common Market. Belgium did not return to the New York capital market until 1961 when a bond issue was sold and a private loan was extended. In 1962 and 1963, the dollar volume of borrowing in the United States by Belgium was modest.

This suggests that the balance of payments situation in the United States, coupled with the emphasis on the development of capital markets in Europe, has caused nations such as Belgium to turn to other sources of long-term funds. Their choice has been restricted, however, because no capital market in the world can match the U. S. in the volume of funds handled and in the institutional mechanism for transferring these funds. Belgium's own capital market is closed to foreign borrowers; other larger capital markets in Europe give preference to domestic borrowers and carefully screen applications from foreign issuers. In 1963, however, Belgium floated a dollar loan in London. Before World War II London had been the capital market of the world, and that city's financial industry has been working to regain some of its former importance. Belgium was able to take advantage of this. In addition, in 1963 Belgian banks took the lead in promoting a new European financing technique: the banks have acted as underwriters in selling several bond issues denominated in Epunits, i.e., European units of account.[8] Each European currency can be expressed as an equivalent of a certain number of Epunits, and the new bonds can be bought, sold, or redeemed in any of the 17 equivalent currencies. The new units of account made it possible to sell a bond issue of a Norwegian bank and one for a Portuguese oil company in any of the 17 countries. In effect, this enlarges the European capital markets significantly by providing the possibility of marketing an issue in several countries at once.

In contrast to Belgium, Norway is a good example of a European country that has stepped up its borrowing in the United States. (Others are Denmark, Finland, and Portugal.) Norway sold capital issues in five of the six years covered in this study, and there was a net increase in the dollar volume of its borrowing in each year from 1960 through 1963. Borrowing by this nation has not been restricted to the national government; several municipalities and private corporations also issued bonds and notes in U. S. markets.

Capital markets in Norway are local and quite small in volume of funds handled. At the same time, Norway, like Canada, needs capital to establish new industries and improved methods of preparing the nation's natural resources for export. While the United States offers the largest source of such funds, Norway also has had a close financial relationship with London. Two new sources of funds may be helpful to Norway in the future, eventually contributing to a decline in their borrowing in the United States. First, a Norwegian borrower already has had occasion to issue a bond denominated in Epunits, thus obtaining access to virtually all of the capital markets of Western Europe. This would include the well-developed markets of Zurich and Amsterdam, which are small relative to the U. S. Second, the suggestion has been made that all Scandinavian nations cooperate in establishing a joint capital market. If this

[8] Epunits (pronounced E-P-U-nits) are an outgrowth of the early postwar European Payments Union. They are units of account used as a common denominator of the currencies of the seventeen nations that belonged to the now-defunct E.P.U. The value of each unit may also be expressed in terms of the value of an amount of gold (nearly nine-tenths of a gram) equal to the gold content of the U. S. dollar. To illustrate the currency equivalents, in October 1963 one Epunit was worth approximately 4.9 French francs or 6.9 Danish krone or 30 Greek drachma, etc. A security denominated in Epunits offers an investor protection against exchange fluctuations or instability in any of the 17 currencies.

Table II
Long-Term Japanese Borrowing in the U. S.
1958-1963

	1958	1959	1960	1961	1962	1963
Japanese borrowing as a proportion of dollar volume of total foreign borrowing in U. S.	1%	3%	7%	15%	10%	15%
Proportion of dollar volume of issues sold:						
by public authorities	—	100	—	70	31	45
by private companies	100	—	100	30	69	55
by public utilities	—	—	—	35	37	25
by manufacturers	100	—	100	30	48	28
by financial institutions	—	—	—	35	15	30
Proportion of dollar volume of issues in form of:						
bonds	—	100	—	70	70	60
notes and loans	100	—	100	8	24	7
stocks	—	—	—	22	6	33
Proportion of dollar volume of issues:						
sold publicly	—	50	—	92	62	76
placed privately	100	50	100	8	38	24

Source: Federal Reserve Bank of Cleveland.

should occur, Norway could readily tap the investment funds available in Sweden or Denmark.

Asia and Australasia. Borrowing by countries in this region is dominated by Australia, New Zealand, and Japan. These nations appear regularly in U. S. capital markets, and their government bonds have been accepted by American investors. In 1962, borrowing by the two Commonwealth nations rose sharply to $110 million, but then declined to a low level last year. Both Australia and New Zealand have capital demands similar to those of Canada and Norway, i.e., sizeable demands for capital to finance public expenditures plus the need to bolster foreign exchange holdings to support the domestic investment program. Apparently Great Britain has not been in a position to supply such a large volume of dollar funds to the Commonwealth countries.

Japan provides the most remarkable case history of any of the foreign nations borrowing capital funds in the United States. In 1958, one Japanese issue was privately placed in the New York market, a $7 million note of a private corporation. In comparison, in 1963, borrowing of long-term capital funds by Japan amounted to nearly $200 million. This was supplemented substantially during the six-year period under review by short-term credits from U. S. banks and exporters. The volume of new Japanese issues sold in the U. S. increased progressively in each year of the period covered by this study. From 1961 through 1963, there was a noticeable increase in the private placement of stocks, or American Depository Receipts, of Japanese industrial firms.[9] Japanese companies were also among the few to issue convertible debentures in foreign capital markets. A summary of these trends appears in Table II. The number of issues sold in 1958-60 was small, causing the proportions in the breakdown to appear large.

The Japanese have openly acknowledged their principal reasons for borrowing in the United States.[10] The explanations are important because they are applicable to many other nations that have sold capital issues in New York.

A number of factors that have led foreign countries to raise funds in the U. S. are listed below. No attempt is made in the listing to rank the motives by importance, because what may be a prime factor in Japan may be quite secondary, for example, in Denmark. In several cases, the Japanese situation has been used as an illustration.

1. Continued economic growth is accepted as one of the chief goals of official policy; such growth is possible only with a high level of capital investment. In Japan, gross investment averaged 35 percent of gross national product during the five-year period ended March 31, 1962.

2. Even with a high rate of domestic savings, internal sources of funds are not sufficient to supply the needs for capital. The Japanese people have one of the highest propensities to save in the world, but Japan still leans heavily on foreign borrowing.

3. The principal source of foreign capital is the United States, because of both the volume of funds that can be tapped and the relative ease of arranging financing operations through commercial and investment bankers.

4. The acceptance of stock ownership by individuals is not important in the country needing capital funds. Here again it is a question of the *volume* of available funds, not the ownership or distribution of the funds.

5. It is vital for many nations to obtain dollars for their balance of payments. Japan, for example, has a sizeable import surplus from the United States, and the imports must be paid for in dollars. This is true for many nations in the world, who must often obtain dollars before buying U. S. products such as heavy machinery. An alternative would be for the United States to accept more payment in the form of goods exported by the debtor nations.

6. Some nations must borrow in order to service their outstanding external debt. This practice has been compared occasionally to an individual borrowing to keep from going into bankruptcy. There is, of course, a limit to such borrowing. This motive

[9] American Depository Receipts represent an equivalent amount of foreign stock issues that are deposited in an accepted U. S. bank or trust company. Thus the U. S. investor buys and holds the ADR's rather than the underlying stock certificates. The use of ADR's makes unnecessary the direct trading of the foreign shares in U. S. securities markets.

[10] Gordon, A. H., "Statement for the record regarding H.R. 8000", U. S. Congress, House Ways and Means Committee, *Hearings on Interest Equalization Tax Act,* August 20-23, 1963, pp. 466-472.

does not apply to Japan; it is more applicable to under-developed nations.

7. Some nations that import capital are almost assuming the role of financial middlemen. To illustrate: it has been suggested that making Japanese access to the U. S. capital market more difficult might result in the cut-off of Japanese economic aid to less-developed nations in the Pacific.

8. At the present time, interest costs are lower in New York than in almost any other part of the world. Only Switzerland and the Netherlands report lower interest rates on bonds, and access to the capital markets of these countries is severely restricted by the respective governments.

9. Some Japanese borrowers, by issuing stocks and bonds in the United States, gained the advantages of publicity in a potential overseas market and contacts with important foreign financial institutions.

Japan's reliance on U. S. capital markets was restrained when the Administration proposed the interest equalization tax. Consequently, Japan has turned to other sources of capital funds. Applications have been made for additional World Bank loans, and Japanese financial officials have traveled to Europe. In August, the national government floated a serial loan in London for the first time since World War II; the offering was oversubscribed substantially. In December, a Japanese corporation borrowed $15 million in the Luxembourg capital market, while another raised $5 million in London. The city of Osaka has borrowed twice in Germany and plans to do so again in 1964. Additional negotiations are being conducted in Switzerland by Japanese borrowers.

Rest of the World. The remaining areas of the world that have not been covered in this discussion are, for the most part, under-developed. This clearly reflects one of the most pressing problems in international economics, namely, those nations most in need of investment capital often encounter the most difficulty in obtaining it. To illustrate: total borrowing in the United States in 1963 by countries in Latin America, Africa, and the Middle East came to little more than $100 million. Nearly half of this total was accounted for by Mexico, with the remainder going to Israel and Mauritania, South Africa, and Panama. Each of these countries could be considered as a special case.

Only three Latin American nations borrowed in the United States in the period covered by this study, and two of these (Mexico and Panama) have a close economic relationship with the U. S. In the case of Panama, borrowing has been based on future income from the Panama Canal. Of the Middle East countries, only Israel has sold capital issues in the U. S., and many of the funds supplied to Israel have been more in the nature of contributions than impersonal investments.[11] In the six-year period ended in 1963, only four African nations or colonies came to New York for capital funds. The two colonies,

[11] Several other nations in the Middle East, while being economically under-developed, are extremely wealthy because of oil resources. Royalty payments from foreign oil companies probably release these nations from dependence on borrowed capital.

Rhodesia and the Belgian Congo, borrowed in 1958 in conjunction with loans from the World Bank; since gaining their independence, neither nation has borrowed in U. S. markets. Finally, the Mauritanian loan obtained in 1963 was co-signed by France, thus adding to its acceptability by American investors.

There are several reasons for the absence of under-developed nations in U. S. markets. First, such countries or their private firms often have difficulty generating enough current income to assume regular payment of principal and interest on external debt. One result in the past has been default. This happened frequently in the 1930's, to the extent that nearly all foreign securities were rejected by American investors. It is only in recent years that U. S. investors have again demonstrated general interest in foreign security issues.

The second reason for the difficulty under-developed nations have in borrowing results from the first. The investment quality of their capital issues fails to meet standards necessary for general market acceptance. The investment quality is determined partly by the borrower's past experience in servicing debt, the political stability of the borrowing country, and the economic policies of the government in question. Hence, because of forced nationalization of major industries, rapid turnover of some governments, and past defaults, U. S. investors have had little interest in acquiring South American securities. At the present time, only Mexico and Argentina issue securities in the U. S. capital markets.

Finally, many under-developed nations do not approve of the use of foreign capital because of a fear that foreign ownership and control will follow. There is a major, and as yet unsolved, conflict between the intense nationalism that is characteristic of many emerging nations and their need for foreign investment capital.

CONCLUSION

For the first time in the postwar period, other nations are rising to the challenge of the United States in developing their own capital markets. The U. S. has encouraged the expansion of these markets as a supplement to our own, hoping to ease the recent burden on the U. S. balance of payments.

Because of the balance of payments situation and the development of foreign capital markets, the United States may be faced with a decision as to the role of its capital market in international finance. As this study has shown, the United States has the most developed capital market in the world. This nation can generate a large supply of capital at a relatively low cost to the borrower. The mechanism for transferring capital freely from investor to borrower is rapid and responsive to change. To maintain the present role of the U. S. capital market, these conditions would have to be continued.

FINANCIAL POSITION OF CONSUMERS

DURING the past decade consumer income and spending have maintained a fairly stable relationship to each other and to Gross National Product (GNP). The consumer sector of the economy has allocated slightly more than four-fifths of personal income for current expenditures, and personal income has continued to be relatively less susceptible to business cycles than GNP as a whole. There have, however, been some changes in consumer attitudes toward acquisitions of financial assets and uses of credit during the ten-year period.

This article examines these changes to determine how they have affected the overall financial positions of consumers. It discusses consumer financial assets and the shifts in relative importance among the various types of financial holdings. It also considers various aspects of the rapid growth in consumer credit and, then, examines changes in the relationship between assets and credit with specific attention to consumer financial liquidity.

CONSUMER ASSETS

At the end of 1962 consumers held financial assets amounting to approximately $1,079 billion.[1] These assets were held in various forms including currency, deposits at various financial institutions, U. S. Government securities, reserves in pension funds and insurance, state and local government securities, and corporate securities. While only demand deposits and currency constitute "money", as usually defined, the typical consumer probably feels that any of these assets represents funds that may be tapped for current and future uses.

Some of these assets, however, are less liquid than others. Pension fund and life insurance reserves are generally tied to future contingencies of retirement, death, or

[1] *Statistical Bulletin,* Securities and Exchange Commission, April 1963. Assets discussed here represent only financial assets and do not include real property holdings such as equity in real estate.

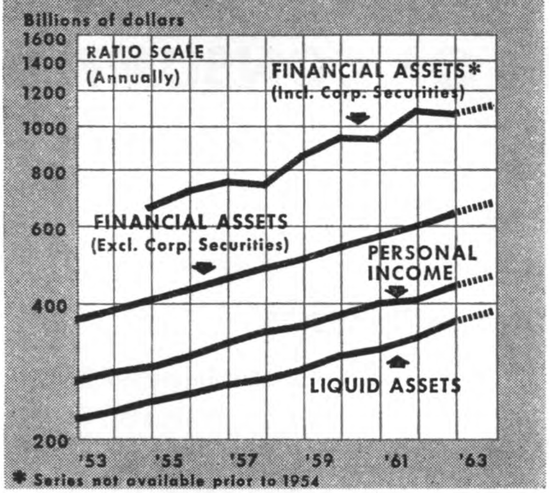
maturity of the insurance policy. These funds sometimes become available as a result of changing jobs, borrowing against the cash value of the insurance policy, or "cashing in" the policy. These procedures can only be followed at some expense to the individual, both in money and in financial security, and therefore the assets are considered nonliquid. Many corporate securities also fall into the nonliquid category because of the risk of capital loss involved in liquidating them.

On the other hand, other forms of consumer financial assets are highly liquid in that they can be converted to spendable form at full value or with a minimum capital loss. Shares in savings and loan associations, credit unions, and savings deposits at commercial banks and mutual savings banks are examples of assets convertible at face value. Marketable U. S. Government securities, principally short-term issues, can frequently be liquidated with little capital loss because of the broad and active market for these securities.

Although consumers increased the dollar volume of all forms of financial assets during

CONSUMER ASSETS

1. ASSETS and INCOME



Source of data: Securities and Exchange Commission; Department of Commerce

CONSUMER HOLDINGS OF FINANCIAL ASSETS [1] — Percentage Distribution, Selected Dates

by Type	Dec. '52	Dec. '56	Dec. '61	June '63
Currency and Demand Deposits	21.3%	17.3%	13.3%	12.7%
Time and Savings Deposits [2]	17.2	17.0	18.2	19.9
Savings Shares [3]	5.1	8.6	12.5	13.9
U. S. Savings Bonds	13.2	10.9	7.7	7.2
Other U. S. Government Securities	4.5	4.4	4.6	4.3
Total Liquid Assets	61.3	58.2	56.4	58.0
State and Local Government Securities	4.3	4.8	4.7	4.0
Private Insurance and Pension Reserves	21.4	23.9	27.0	26.4
Government Insurance and Pension Reserves [4]	12.8	13.2	11.9	11.7
TOTAL Financial Assets	100%	100%	100%	100%

(not additive due to rounding)

1 Excluding corporate securities
2 Includes savings deposits at commercial banks and mutual savings banks
3 Includes savings shares at savings and loan associations and at credit unions
4 Excludes social security

Source of data: Securities and Exchange Commission the past ten years, there have been significant changes in the relative importance placed on the individual types of assets.

Over the past decade consumer liquid assets advanced to a level of $371 billion with little change in relation to personal income. During the ten-year period, personal income expanded at an average annual rate of 4.9 percent while liquid assets advanced at an average pace of 5.0 percent per year.

Within the total of liquid assets, however, there have been important changes in the types of holdings. A comparison of the percentage distributions at the end of 1952 and 1962 reflects a growing awareness on the part of the consumer of the earning potential of savings. During the decade, currency and demand deposits (non-interest-bearing liquid assets) fell from more than 21 percent to 13 percent of total financial assets. At the same time, shares at savings and loan associations and credit unions advanced from only 5 percent to more than 13 percent, and savings deposits at commercial banks and mutual savings banks fluctuated from 17.0 to 19.5 percent of the total. The difference in trend between savings shares and savings deposits reflects, at least in part, the generally higher level of interest rates at savings and loan associations and credit unions as compared with commercial banks and mutual savings banks.

During the ten-year period, consumer investment in U. S. savings bonds declined sharply in relation to investment in other assets, dropping from 13.2 percent at the end of 1952 to 7.3 percent in December 1962. Savings bonds are relatively low-yield investments as compared with deposit-type savings and are not as liquid as the former. Although they are redeemable at full value, Series E bonds can be redeemed only after two months from issue date and Series H bonds only after six months from issue date and with thirty days notice. Also, the rate of interest increases as the bonds near maturity so that they can be redeemed earlier only at some sacrifice of earnings.

The proportion of consumer holdings of marketable U. S. Government securities has fluctuated somewhat from year to year but has shown no consistent directional tendency over the decade.

In line with the increased sophistication on the part of the consumer toward his financial investments, the value of individual holdings of corporate securities has advanced sharply in recent years. While the series is not available prior to 1954, individual holdings of corporate stocks and bonds advanced at an average annual rate of 8.3 percent from the end of 1954 to December 1962. The rapid growth rate can be attributed, in large part, to the increase in market value and, in some measure, to the increased interest in securing long-term capital appreciation through the increase in market price of corporate stocks. As is shown in Chart 1, values of corporate securities holdings have fluctuated widely with market conditions, but over the past five years, consumer holdings of corporate securities have consistently represented more than a third of their total financial investments.

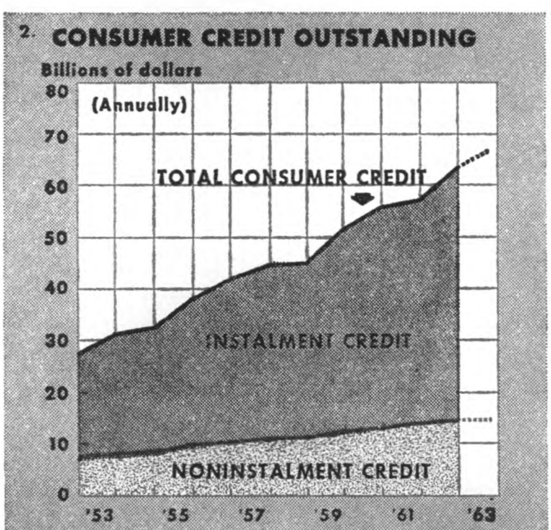
Along with the increase in emphasis on higher yield for their financial assets, individuals have also displayed a growing concern for future financial security. The share of financial assets taking the form of reserves in pension funds and insurance expanded to 38 percent at the end of 1962, up from 34 percent at the close of 1952. The proportionate increase has occurred entirely in private pension and insurance plans as opposed to government-sponsored plans. In large measure, private pension funds are responsible for the differential between the growth rates. Whereas public pension plans were well established prior to the beginning of the decade, private pension programs are a rapidly expanding entity in number of plans, in number of people covered, and in dollar volume of fund reserves.

On the whole, liquid assets have represented a declining share of total consumer assets. As a percent of total financial assets excluding corporate securities, liquid assets declined from 61 percent at the end of 1952 to 56 percent at the close of 1961. During 1962, however, the shares of total assets held in liquid form advanced to 58 percent. This rise was precipitated by the inflow of savings into commercial banks and savings and loan associations following increases in rates paid on savings early in 1962. Part of the shift to deposit-type savings may also reflect declines in market value of corporate securities in the first half of 1962, making the liquidity offered by savings shares and deposits, coupled with the increased interest rates, relatively more attractive.

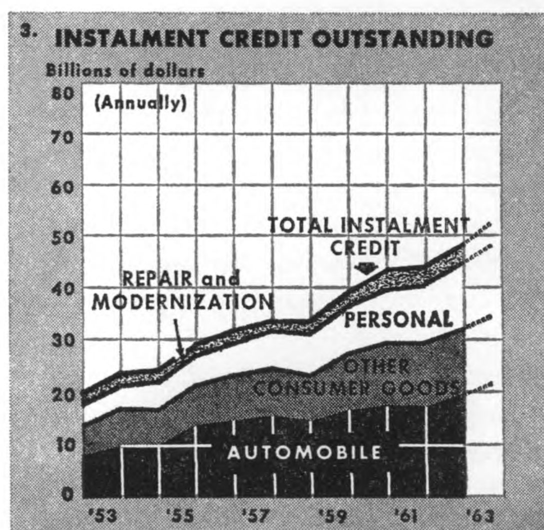
CONSUMER CREDIT

On the opposite side of the consumer balance sheet, consumer debt amounted to approximately $240 billion, or less than one-

CONSUMER CREDIT



Source of data: Board of Governors of the Federal Reserve System



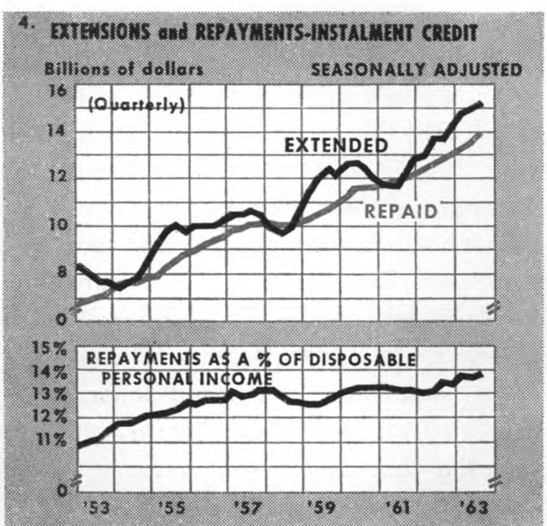
Source of data: Board of Governors of the Federal Reserve System fourth of the volume of their total financial assets, at mid-1963. This estimate of consumer debt includes the total of mortgage credit on one- to four-family dwellings as well as the conventional measure of instalment and noninstalment credit.[2]

Over the past decade, mortgage credit on one- to four-family residential property, which is secured by equity in real estate investment, has advanced at a relatively steady pace. Such credit nearly tripled in dollar volume between the end of 1952 and mid-1963.

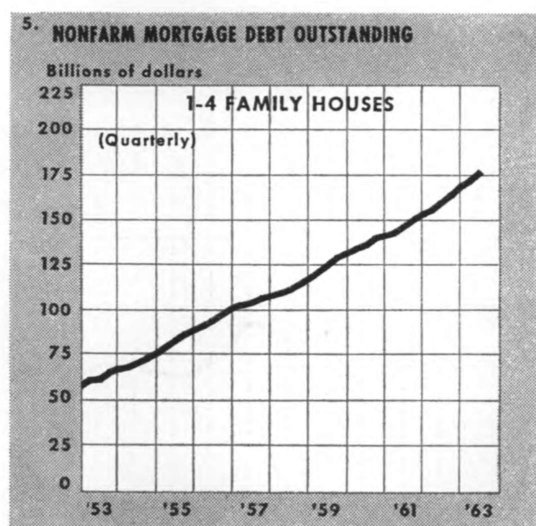
The demand for consumer credit, on the other hand, has responded to changes in business conditions, particularly in the instalment sector. Seasonally adjusted noninstalment credit, which includes charge accounts and single payment bank loans, rose steadily to $15 billion in September 1963, nearly double the December 1952 level; while instalment credit amounted to $51.8 billion in September, or 2.7 times the December 1952 level on a seasonally adjusted basis.

Instalment credit is the most volatile sector of consumer credit, declining in times of business recession and rising strongly in periods of expansion. In particular, two segments of instalment credit, automobile loans and loans for repair and modernization of homes, reflect economic conditions. Over the decade as a whole, automobile loans and personal loans have accounted for the largest share in total expansion of instalment credit.

[2] Total mortgage credit on one- to four-family dwellings is used here as an approximation of consumers' real estate indebtedness. Consumer credit data are estimated by the Federal Reserve Board of Governors from monthly reports of a sample of lending institutions that extend credit to consumers.



Source of data: Board of Governors of the Federal Reserve System; Department of Commerce

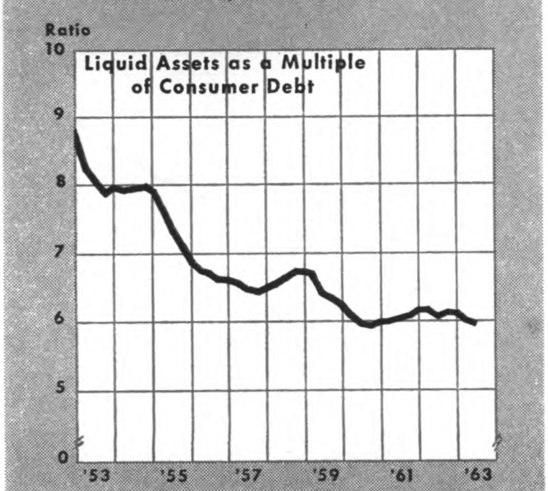


Source of data: Board of Governors of the Federal Reserve System

From December 1952 to the present, extension of instalment credit has exceeded repayment with the exception of the recessions of 1957-58 and 1960-61. The rapid growth in consumer credit has raised questions in some quarters regarding the ability of consumers to repay. As is shown in Chart 4, repayments of instalment credit represented 13.8 percent of disposable personal income in the third quarter of 1963, up from 10.6 percent in the fourth quarter of 1952.

The fact that the repayment burden of consumer debts has grown at a faster pace than disposable personal income reflects several changes in consumer attitudes and economic positions. For example, a greater percentage of consumers now use instalment credit to finance expenditures than in earlier years. The Survey Research Center at the University of Michigan reports that 50 percent of all consumer spending units had instalment credit outstanding in 1963 while only 38 percent had such debt in 1952. In addition, expenditures for basic items, e.g., food, clothing, and shelter, have demanded a declining share of personal income, freeing a larger share for repaying credit used to finance items such as new automobiles, vacation trips, and home improvements. In general, consumers have displayed a greater willingness to pay for durable goods out of current income, and to absorb the extra cost, in interest and service charges, for the privilege of using the goods before they are fully purchased.

6. CONSUMER LIQUIDITY RATIO



Source of data: Securities and Exchange Commission; Board of Governors of the Federal Reserve System

NET FINANCIAL POSITION

During the past decade consumer attitudes toward both assets and debt have changed. On the asset side, individuals have sought higher yields on financial holdings as well as increased financial security in preparation for retirement or death. The result of this shift in emphasis has been a relatively faster rate of growth in the nonliquid portion of financial assets, the segment that includes pension programs, life insurance, and corporate securities. Within the liquid segment of financial assets, consumers have invested a declining proportion of their inflowing funds in noninterest-bearing demand deposits and currency and low-yield U. S. Government savings bonds, while they have placed a growing share of their resources in shares in savings and loans and credit unions that yield relatively high rates of return.

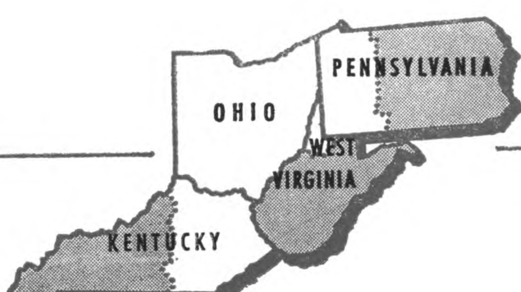
On the debt side, use of consumer credit has expanded at a faster pace than either financial holdings or personal income. From 1952 to the present, instalment credit repayment has claimed an increasing proportion of personal disposable income. At the same time, consumer financial liquidity has declined. As is shown in Chart 6, the ratio of consumer liquid assets to consumer credit, excluding mortgage debt, has declined rather sharply over the decade.[3] Thus, consumers are experiencing an apparent decline in liquidity, i.e., their net worth represents a declining proportion of both their financial assets and current disposable income.

Theoretically, a downturn in liquidity is accompanied by a lesser willingness to spend. Other factors must be taken into consideration, however, to determine whether or not such a development should be considered a harbinger of a tapering off in consumer spending. For example, the widespread use of pension funds and insurance of all kinds has lessened the need to hold money in store for future or unforeseen events. Purchases of fire and casualty insurance and accident and health insurance do not appear in financial assets even though they lessen the need to hold liquid assets for unexpected expenses.

In regard to the rapid rise in consumer debt, repayment of credit is being spread out over a larger number of people as an expanding percentage of consumer spending units uses debt financing. In addition, a larger share of personal income can be used to repay debt as incomes increase. The lack of severe fluctuations in the economy since World War II has fostered confidence on the part of consumers that their earning capacity will be maintained. Consequently, they have demonstrated increased willingness to purchase durable goods on credit and to pay for them while they use them rather than postponing the expenditure until they have saved enough for the purchase. In addition, many of those who borrow have savings in some form that they hold for unexpected needs.

[3] Mortgage credit is not included in the liquidity ratio as, in effect, such credit represents enforced periodic investment in real property equity, so that only interest and service charges and property depreciation represent liabilities not directly balanced by assets.

50 YEARS
FEDERAL RESERVE
SYSTEM



Fourth Federal Reserve District