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EXPERIENCE WITH SPECIAL DRAWING RIGHTS

Special Drawing Rights (SDRs) are a new type of international monetary reserve asset created by the International Monetary Fund (IMF). After several years of discussion and negotiation, these new reserve assets were initially created and made available to participating countries for use in official payments transactions on January 1, 1970. This article discusses the underlying economic conditions that led the IMF membership to develop the SDR facility, describes the more important operational aspects of SDRs and their use, and surveys the first year of experience with this new international reserve asset.

REASONS FOR DEVELOPING SPECIAL DRAWING RIGHTS

The Special Drawing Rights facility was developed to assist in the provision of international reserves in quantities adequate to meet the combined desires of nations for reserves. Nations need international monetary reserves—gold, foreign exchange, SDRs, and reserve positions in the IMF—to help finance balance of payments deficits when they occur.

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It is difficult to determine the amount of reserve holdings that a nation's leaders would consider adequate for its needs. The amount deemed adequate would be influenced by the volume and volatility of its international commercial transactions, e.g., imports, exports, international capital movements, etc., and by the likelihood and magnitude of speculative capital movements. Speculative capital movements and changes in the volume and timing of commercial transactions (which may also be speculative in nature) may tend to alter the exchange rate of a nation's currency or cause a deficit in its balance of payments.

A measure sometimes used in efforts to assess the adequacy of reserve holdings—of individual nations and of the world—is the ratio of gross reserves to annual imports. Robert Triffin, after a study of this ratio and the balance of payments policy actions of twelve major trading countries for the period 1950 through 1957, concluded that:

The overall record of these eight postwar years strongly suggests that most of the major countries would aim at maintaining a reserve level of not less than 40 percent in most years, feel impelled to adopt severe adjustment measures if this level fell below, let us say, 30 or 33 percent, and consider themselves forced to adopt drastic measures of control in the face of any persistent or substantial contraction below that critical range.¹

Both world gross reserves and world trade have grown substantially in the last fifteen years, but

¹Robert Triffin, *Gold and the Dollar Crisis* (New Haven: Yale University Press, 1960), pp. 45-46.

the growth of reserves has not kept pace with the growth of trade. Therefore, the ratio of gross reserves to annual imports for the world has declined substantially. World gross reserves increased from \$56 billion in 1955 to \$78 billion in 1969, an increase of 39 percent (see Table I). Over the same period, annual world imports grew from \$89 billion to \$254 billion, an increase of 185 percent, causing the reserves-to-imports ratio to fall from 63 percent to 31 percent. (The year 1970 was apparently an exception to this pattern. Complete data are not yet available, but preliminary estimates indicate a growth in gross world reserves of 18 percent in 1970 compared with growth in world trade of 13 percent.) Since 1955, the experience of most major trading nations has been parallel to the overall pattern, with imports experiencing strong growth, reserves growing less rapidly, and the reserves-to-imports ratios declining substantially. United States gross reserves actually fell from \$23 billion in 1955 to \$17 billion in 1969; during this period, the United States reserves-to-imports ratio declined from 184 percent to 44 percent.

Many observers, including Triffin, realized that the reserves-to-imports ratio was not a faultless indicator of the need for reserves. Some economists attempted to use the size of past international payments imbalances as an indicator of the appropriate level of reserves for a nation.²

²See, for example, Weir M. Brown, *The External Liquidity of an Advanced Country*, Princeton Studies in International Finance, No. 14, (Princeton, New Jersey: Princeton University Press, 1964). Another important study examines both payments imbalances and imports in assessing the need for reserves; see George H. Willis and Fred L. Springborn, *The Need for International Reserves*, U. S. Treasury Department, September 1967, printed in U. S. Congress, Joint Economic Committee, *New Plan for International Monetary Reserves*, 90th Congress, 1st Session, 1967.

TABLE I

Gross Reserves and Annual Imports of the World
and Major Industrial Nations

Selected Years

(mil. of \$)

	<u>World*</u>	<u>United States</u>	<u>United Kingdom</u>	<u>Industrial Europet</u>	<u>Canada</u>	<u>Japan</u>
<u>1955</u>						
Gross reserves	\$ 55,903	\$22,798	\$ 2,390	\$11,882	\$ 1,985	\$ 832
Annual imports‡	89,300	12,370	10,809	25,923	5,020	2,471
Ratio of gross reserves to annual imports	62.6%	184.3%	22.1%	45.8%	39.5%	33.7%
<u>1960</u>						
Gross reserves	\$ 60,510	\$19,359	\$ 3,719	\$20,094	\$ 1,991	\$ 1,949
Annual imports‡	119,000	16,051	12,765	39,422	6,124	4,491
Ratio of gross reserves to annual imports	50.8%	120.6%	29.1%	68.3%	32.5%	43.4%
<u>1965</u>						
Gross reserves	\$ 70,710	\$15,450	\$ 3,004	\$29,923	\$ 3,037	\$ 2,152
Annual imports‡	175,200	23,186	16,103	64,370	8,713	8,170
Ratio of gross reserves to annual imports	40.4%	66.6%	18.7%	46.5%	34.8%	26.3%
<u>1969</u>						
Gross reserves	\$ 77,580	\$16,964	\$ 2,527	\$28,288	\$ 3,106	\$ 3,654
Annual imports‡	254,300	38,530	19,956	96,470	14,250	15,026
Ratio of gross reserves to annual imports	30.5%	44.0%	12.7%	29.3%	21.8%	24.3%

* Coverage varies but always excludes Soviet Area countries.

† Totals combined for the following nations: Austria, Belgium-Luxembourg, Denmark, France, Germany, Italy, Netherlands, Norway, Sweden, and Switzerland.

‡ Imports are CIF.

Source: International Monetary Fund, *International Financial Statistics*, March 1956, December 1961, and December 1970

Although there was disagreement about which measure of the need for reserves was best, or indeed, if the need for reserves could be measured at all, there was rather general agreement in the mid-1960's that there was a need for reserve growth,³ and that the traditional sources of

reserve growth were then, or might soon become, inadequate. Furthermore, there was widespread agreement that an inadequate global total of reserves might lead to undesirable competition among nations for shares of the existing stock of reserves. Competition for reserves could be exhibited in such forms as restrictions on imports and on capital outflows, or even in restrictions on domestic activity.

The major sources of reserve growth, prior to the birth of the Special Drawing Account of the

³For a study emphasizing the need for reserve growth *per se*, in contrast to the need for any level of reserves, see Fritz Machlup, *The Need for Monetary Reserves*, Reprints in *International Finance*, No. 5 (Princeton, New Jersey: Princeton University, October 1966).

IMF, were newly available gold and United States balance of payments deficits. However, dependence on either or both of these sources of new reserves entails serious disadvantages. A major disadvantage of depending on newly available gold for additions to the stock of free world reserves is that the supply of such gold, both from Soviet gold sales and free world gold mining, is undependable.⁴ For instance, annual gold sales to the free world by the Soviet Union in the period from 1960 through 1965 ranged from \$200 million to \$550 million; in contrast, there were no Soviet gold sales in the years 1966 through 1970. During 1960-1968, annual free world gold production averaged \$1,352 million, with South Africa accounting for 72 percent of the production. Discovery, depletion, and changes in gold production techniques and costs affect the quantity of newly mined gold. Most of the newly available gold is absorbed by industry and the arts and by hoarders, and only the small remainder is available to supplement world reserves. In fact, the remainder was actually negative in 1966, 1967, and 1968. As part of the so-called two tier system for gold, governments and central banks have generally refrained from purchasing gold in private markets since March 1968. At that time, the governors of the central banks of seven major nations, including the United States, agreed that "as the existing stock of monetary gold is sufficient in view of the prospective establishment of the facility for Special Drawing Rights, they no longer feel it necessary to buy gold from the

⁴Data on gold production in the Sino-Soviet Bloc are generally unavailable. The supply of new gold available to the free world is usually considered to be the sum of gold newly mined in the free world plus gold sales to the free world from the Soviet Union.

market."⁵

United States balance of payments deficits may result in increased holdings of United States dollars by foreign monetary authorities, thereby adding to their gross reserve assets, as well as to those of the world as a whole. A serious disadvantage, however, of United States payments deficits as a continuing source of reserves is that as foreign holdings of dollars increase relative to United States holdings of gold, foreign confidence in the dollar as a reserve asset tends to decline.

HISTORICAL DEVELOPMENT OF SPECIAL DRAWING RIGHTS

Discussion of the possibility of a global shortage of international monetary reserves was stimulated by the publication of Robert Triffin's book, *Gold and the Dollar Crisis* in 1960.⁶ In 1963, two studies were commissioned on "the outlook for the functioning of the international monetary system." These reports acknowledged the possibility of a global shortage of reserves. Subsequent studies and discussions on means of creating additional reserves culminated in 1967 in the IMF Board of Governors' acceptance of an "Outline of a Facility Based on Special Drawing Rights in the International Monetary Fund." The substance of this "Outline" was then put into the form of an amendment to the *Articles of Agreement* of the IMF that became effective on July 28, 1969.⁷

⁵See *Federal Reserve Bulletin*, March 1968, p. 254 and January 1970, p. 107.

⁶Triffin, *op. cit.*

⁷For further details on the events which led to amendment of the *Articles of Agreement*, see Fritz Machlup, *Remaking the International Monetary System: The Rio Agreement and Beyond* (Baltimore: The Johns Hopkins Press, 1968), pp. 3-6 and Joseph Gold, *Special Drawing Rights: Character and Use*, second edition, Pamphlet Series No. 13 (Washington, D. C.: International Monetary Fund, 1970), pp. 1-11.

Adoption of the amendment, which required approval by three-fifths of the members and four-fifths of the total votes,⁸ did not, however, create any SDRs. The amended Articles provide for an allocation of SDRs only after the Managing Director of the IMF has proposed an allocation and the proposal has been approved by a simple majority of the votes of the Executive Directors of the IMF, and by 85 percent of the votes of the Board of Governors of the IMF.

The first proposal to allocate the new reserve asset, approved by the Board of Governors of the IMF on October 3, 1969, provided for an allocation of approximately 9.5 billion SDRs⁹ in three steps: approximately 3.5 billion SDRs on January 1, 1970, and approximately 3.0 billion SDRs on the first days of 1971 and 1972.¹⁰ SDRs are allocated among the participating nations in

⁸The number of votes that each IMF member nation has is roughly proportional to that nation's IMF quota. For instance, the United States quota is at present 23.56 percent of the total of the quotas in the IMF General Account, and the United States has 21.45 percent of total votes in the General Account.

⁹One SDR is equivalent to 0.888671 gram of fine gold. The United States dollar is also equal to 0.888671 gram of fine gold.

¹⁰The authority for the first three allocations of SDRs and the basis for calculating the amounts of the allocations is Resolution Number 24-12, which may be found in IMF, *Summary Proceedings of the Twenty-fourth Annual Meeting of the Board of Governors, September 29-October 3, 1969* (Washington, D. C.: 1969), p. 326. The amounts of SDRs actually distributed in the first two allocations were 3,414 million and 2,949 million, respectively. The main reason for the first two actual allocations being different from the expected allocations is that The Republic of China elected not to receive its allocations. China's first two allocations would have been 92.4 million SDRs and 59 million SDRs, respectively.

proportion to their IMF quotas. The United States received the largest amounts of SDRs in each of the first two allocations (867 million and 717 million, respectively); and Great Britain was granted the second largest amounts of SDRs (410 million and 300 million, respectively;) (see Table II).

NATURE OF SPECIAL DRAWING RIGHTS

Special Drawing Rights are credits on the books of the newly created Special Drawing Account of the IMF. In contrast, the traditional operations and transactions of the IMF are carried out through the General Account. Although the IMF operates the two accounts, they are entirely separate.

The value of the SDR is defined as a certain weight of fine gold. Because the gold value cannot change (except through amendment of the IMF *Articles of Agreement*), the SDR has a guaranteed gold value. The par values of currencies of IMF member nations are expressed, directly or indirectly, in terms of gold. If a currency were to be devalued in terms of gold, one SDR could then be exchanged for more units of that currency than it could have been exchanged for before the devaluation. If all currencies were uniformly devalued, leaving their exchange rates unchanged but raising the price of gold in terms of all currencies, the gold value of the SDR would be unchanged. One SDR could then be exchanged for more units of any currency than prior to the devaluations.

Uses of SDRs. Only participating nations and the General Account of the IMF can own SDRs. Since SDRs cannot be transferred to private parties, they cannot be used directly in the markets to support the exchange rate of a nation's currency. Instead, a nation can transfer SDRs to

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TABLE II

Allocations and Holdings of Special Drawing Rights
(mil. of SDRs)

Participant	SDR Allocations January 1, 1970	SDR Holdings December 31, 1970	SDR Holdings as a Percent of Initial Allocations December 31, 1970	SDR Allocations January 1, 1971
Industrial countries	2,276.2	2,423.3	106%	1,954.8
United States	866.9	850.7	98	716.9
United Kingdom	409.9	265.7	65	299.6
Industrial Europe	753.3	978.5	130	692.2
Austria	29.4	38.2	130	18.7
Belgium	70.9	204.9	289	69.6
Denmark	27.4	17.4	64	27.8
France	165.5	171.4	104	160.5
Germany (Federal Republic)	201.6	257.6	128	171.2
Italy	105.0	76.7	73	107.0
Luxembourg	3.2	3.2	100	2.0
Netherlands	87.4	144.1	165	74.9
Norway	25.2	27.2	108	25.7
Sweden	37.8	37.8	100	34.8
Canada	124.3	182.1	146	117.7
Japan	121.8	146.3	120	128.4
Other developed areas	284.8	218.7	77	247.0
Less developed areas	853.1	481.9	56	747.6
Latin America	330.0	272.2	82	275.9
Middle East	77.4	9.3	12	81.1
Other Asia	277.7	98.7	36	242.4
Other Africa	168.0	101.7	61	148.2
Country total	3,414.0	3,123.9	92	2,949.4
IMF General Account	—0—	290.2	8*	—0—
TOTAL	3,414.0	3,414.0	100%	2,949.4

NOTE: Components may not add to totals because of rounding.

* The General Account received no initial allocation of SDRs. Its holdings are expressed here as a percent of the total initial allocation to countries.

Sources: International Monetary Fund, *International Financial Statistics*, February 1971 and *Press Release No. 820*, January 2, 1971

another participating country in exchange for a convertible currency and then use that currency in market support operations.

The transfer of SDRs among participating nations in exchange for currency is expected to be

the major use of SDRs. When a participating nation wishes to use SDRs to obtain currency, the recipient may be determined in either of two ways. The IMF will, if requested, designate one or more participating countries to accept the SDRs

and to provide convertible currency in return. Alternatively, an exchange of SDRs for currency may be arranged by mutual agreement among the nations involved. In the latter case, the nation transferring the SDRs must, with some exceptions, receive its own currency in return.¹¹

The United States can use SDRs to purchase dollar balances from other nations in either of the two ways described above. The transfer of SDRs by mutual agreement may be of particular importance to the United States. The use of this method can help to insure that when the United States sells its SDRs it will be acquiring dollars from those nations that are the most anxious to sell them. If the recipient of SDRs were designated by the IMF, the nations chosen might not be those most anxious to sell dollars. Those nations anxious to sell might then use their excess dollar holdings to purchase gold from the United States, perhaps against this country's preference.

A nation designated to receive SDRs must provide an "acceptable" convertible currency in return. At present, eight currencies are acceptable to the IMF for use in SDR transactions: United States dollar, British pound, French franc, Belgian franc, German mark, Italian lira, Netherlands guilder, and Mexican peso. The nation transferring SDRs to a designated recipient may accept whichever of the eight currencies the other nation elects to provide, or it may specify one of the following three currencies: United States dollar, British pound, or French franc. If the currency provided by the SDR recipient is not the currency specified by the SDR transferor, however, there are proce-

dures through which the former may be converted into the latter.¹²

The guarantee of usefulness of SDRs is inherent in the provision that the IMF will designate a nation that must accept SDRs tendered by a participant and provide convertible currency in exchange. The Executive Directors of the IMF prepare designation plans listing participating nations that may be assigned to receive SDRs and specifying the maximum amounts of SDRs that each may be directed to accept. The plans are prepared at three-month intervals for the following quarter.

In general, a participating nation:

...shall be subject to designation if its balance of payments and gross reserve position is sufficiently strong, but this will not preclude the possibility that a participant with a strong reserve position will be designated even though it has a moderate balance of payments deficit.¹³

The IMF does not publish designation plans. The Fund has reported, however, that the first designation plan listed 23 nations and a potential total of 350 million SDRs; the second plan listed 22 nations and a potential total of 342.5 million SDRs; and the third plan listed 26 countries and 201 million SDRs.¹⁴

One restriction on the transfer of SDRs to another participant, either by designation or

¹²For an explanation of the criteria for determining acceptable convertible currencies and the mechanisms for providing and converting currencies, see Gold, *op. cit.*, pp. 36-47.

¹³*Articles of Agreement of the International Monetary Fund*, Article XXV, Section 5(a)(i).

¹⁴International Monetary Fund, *1970 Annual Report* (Washington, D. C.: 1970), p. 31.

¹¹In certain transactions, which must be prescribed by the IMF, any currency acceptable to both parties may be given in exchange for SDRs. See *Articles of Agreement of the International Monetary Fund*, Article XXV, Section 2(b)(ii).

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mutual agreement, is the "expectation" that SDRs will be sold only by nations that have a "need" to do so. The *Articles of Agreement* state that:

...a participant will be expected to use its special drawing rights only to meet balance of payments needs or in the light of developments in its official holdings of gold, foreign exchange, and special drawing rights, and its reserve position in the Fund, and not for the sole purpose of changing the composition of the foregoing as between special drawing rights and the total of gold, foreign exchange, and reserve position in the Fund.¹⁵

The IMF cannot refuse to facilitate a transaction even if it believes that the nation using SDRs has no need to use them. The IMF could, however, subsequently designate such a nation to receive SDRs.

There are two quantitative restrictions on the use and receipt of SDRs. Although a nation may use all of its SDRs, its holdings of SDRs must average, over a five-year period, at least 30 percent of its net cumulative allocation. (The net cumulative allocation is the sum of a participant's allocations of SDRs less its share of any cancellations.) In effect, then, 70 percent of an allocation is an owned reserve and 30 percent is somewhat like a line of credit.¹⁶ This provision

¹⁵*Articles of Agreement of the International Monetary Fund*, Article XXV, Section 3(a).

¹⁶The 30 percent differs from a line of credit in that with the latter a borrower normally need only repay his borrowing (with interest). In the case of a nation using more than 70 percent of its SDRs, it is necessary not only to restore SDR holdings to 30 percent of the net cumulative allocation but to restore holdings to a level sufficiently above 30 percent so that holdings average 30 percent over a five-year period.

represents a compromise between those nations that wanted the new facility to provide only a line of credit and those that wished it to provide unconditional reserves. Recipients of SDRs are protected by the provision that no nation need accept additional SDRs if its holdings are three times its net cumulative allocation.

In addition to the transfer of SDRs from one nation to another in exchange for convertible currency, a nation may use SDRs to repurchase its own currency from the IMF General Account. When a nation "borrows" from the IMF General Account, it actually purchases foreign exchange from the IMF with its own currency. It later "repays" its loan by repurchasing its currency from the IMF.

Some other purposes for which a nation may use SDRs are to pay IMF assessments for the operating expenses of the Special Drawing Account and to pay charges imposed on participants in the SDR facility. Each participant pays an annual charge to the IMF based on its net cumulative allocation of SDRs. In return, each participant receives interest from the IMF based on its average holdings of SDRs. The rate of interest and the rate of charges must be equal; they are presently 1 1/2 percent per year. Obviously, when a nation's average holdings of SDRs are equal to its net cumulative allocation, the charges and interest payments exactly offset each other. If its average holdings exceed its net cumulative allocation, a nation will receive some net interest; in the opposite case, charges paid will exceed interest received.

In turn, the IMF may use SDRs, specifically, to pay remuneration to participants on their creditor positions in the General Account and, as previously mentioned, to pay interest to participants on their holdings of SDRs. SDRs may also be used in

the IMF's distributions of its net income and when the General Account purchases currencies from member nations to replenish its holdings of those currencies.

SDRs and Gold. Special Drawing Rights are often referred to in the press as "paper gold." It may be useful, therefore, to note the similarities and differences between SDRs and gold. One way in which SDRs and gold are similar is that both are unconditional reserves in that they may be used at the discretion of the holder without the need for approval from an outside agency. In addition, SDRs are linked to gold in the sense that their unit of value is expressed in an unchanging physical quantity of gold.

SDRs differ from gold in that interest is earned (or paid) on the amount by which a nation's SDR holdings exceed (or are less than) its net cumulative allocation. Also, there is no counterpart with gold for the 30 percent restriction on the use of SDRs mentioned above. Perhaps the most significant difference between these two reserve assets is that SDRs can be created without cost (ignoring costs of negotiation and consultation) in whatever amounts are needed, whereas real resources must be used to produce gold, with consequent economic limitations on the amounts of gold that are produced.

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Of the 117 member nations of the IMF, 110 have elected to be participants in the Special Drawing Account.¹⁷ SDRs were allocated to 104

nations on January 1, 1970, and to 109 nations on the first day of 1971.¹⁸ Each participating nation received an allocation equal to 16.8 percent of its IMF quota in the first allocation and 10.7 percent in the second allocation. In the first allocation, individual allotments ranged from 866.9 million SDRs for the United States to 504,000 each for Botswana and Lesotho.

The first year of operation of the new SDR facility was recently concluded, and it is appropriate to examine the experience of that year. In the following discussion, the absolute and relative amounts of SDRs used by nations are examined; usage of SDRs by developed nations is compared with that of less developed nations; and the nature of the transactions is summarized. Similarly, the SDR receipts of nations are surveyed in terms of their absolute and relative amounts, their sources, and the level of development of their recipients. Receipts and uses of SDRs by the IMF General Account are also summarized.

For each month in 1970, with the exception of September and October, the IMF published a list of countries using SDRs and the amounts used, and a list of countries receiving SDRs and the amounts received. However, the IMF publishes country holdings of SDRs as of the end of each month and *net* transactions of a nation during any month may be easily deduced from these data. Some information is lost with this procedure on those occasions when a nation is both a receiver and a user of SDRs in the same month. In the January through August period, however, there were only four such occasions out of 198 times

¹⁷ IMF members that have elected not to be participants in the Special Drawing Account are Ethiopia, Kuwait, Lebanon, Libyan Arab Republic, Portugal, Saudi Arabia, and Singapore.

¹⁸ The five nations that became participants after the 1970 allocation are Barbados, Iraq, Nepal, Thailand, and Yemen Arab Republic. The Republic of China was a participant but elected not to receive the first two allocations.

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when SDRs were used or received. Thus, the data on experience with SDRs presented here are, when possible, based on actual receipts and uses of SDRs; for September and October, net monthly changes in country holdings of SDRs are used with the assumption that no nation was both a user and a recipient of SDRs within the same month.

The participant nations made substantial use of SDRs during the first year of operation of the new scheme. During this period, 59 of the 104 nations that shared in the initial allocation used 857 million SDRs. The two major users of the new asset, judged in terms of *gross* amount used, were the United States and Great Britain, with uses totaling 160.5 million SDRs and 155.1 million SDRs, respectively. The nations using the next largest amounts were India (85.3 million), Italy (50 million), and Indonesia (34.8 million). The major users on a *net* basis (after receipts of SDRs are deducted) were the United Kingdom (144.2 million), India (81.8 million), Indonesia (34.8 million), and Italy (28.3 million). The United States ranked fourteenth as a net user of SDRs, having used only 16.2 million SDRs. In contrast, 45 nations made no use of SDRs, except to pay their share of the assessment for operating expenses.

Of the four major net users, only Indonesia, which used 100 percent of its allocation, would be considered a major user if judged by the criterion of percent of allocation used. Fifteen of the 104 original participants used (net) 100 percent, and 39 nations used (net) 70 percent or more of their initial allocations. Of these 39 nations, only five—Greece, Iceland, Turkey, Yugoslavia, and New Zealand—are categorized by the IMF as developed nations. Among the 34 less-developed nations that used 70 percent or more of their

initial allocations in the first twelve months, fifteen are in Africa, eleven are in Latin America, four are in Asia, and four are in the Middle East.

The impression given by the foregoing data that the less developed nations made greater use of SDRs is correct. Only 20 percent (five out of 25) of the developed nations used 70 percent or more of their initial allocations during the first year, in contrast to 43 percent (34 out of 79) of the less developed nations that did the same. As a group, the developed countries' holdings of SDRs at the end of 1970 were about 3 percent greater than their initial allocation, whereas the combined holdings of the less-developed participants were only 56 percent of the combined amount initially allocated to them. The reduction in the SDR holdings of less-developed countries as a group reflects the tendency toward deficits in those countries' balances of payments. The tendency toward deficit is a result primarily of those countries' urgent needs to import real resources.

The purchase of convertible currency, usually United States dollars, from other participants was the major use of SDRs. Approximately 472 million of the 857 million SDRs used by participating nations were employed for that purpose. The second most important use of SDRs was the repurchase by nations of their own currencies from the IMF General Account. A total of 293 million SDRs were used, by 34 nations, in that way. Participants transferred 92 million SDRs to the IMF General Account to pay charges related to their use of the Fund's resources. Participants also used relatively small amounts of SDRs to pay their assessments for the cost of operating the Special Drawing Account and to pay the amounts by which their charges on cumulative allocations

exceeded interest due on average holdings of SDRs.¹⁹

During the first year of operation of the Special Drawing Account, 42 countries had SDRs transferred to them. The major recipients of SDRs, measured in terms of *gross* receipts of SDRs, were the United States (144.3 million SDRs), Belgium (134 million SDRs), Canada (57.8 million SDRs), the Netherlands (56.7 million SDRs), and Germany (56 million SDRs). Measured in terms of *net* receipts of SDRs, the major recipients and the amounts received were the same, except that the United States was a net user of SDRs. As mentioned earlier, the United States used 160.5 million SDRs, an amount 16.2 million SDRs greater than its gross receipts.

Another measure that can be used to compare the importance of nations as recipients of SDRs is net receipts of SDRs as a percent of initial SDR allocation (see Table II). Judged by that measure, Belgium was also the leading recipient, having received by the end of December an amount of SDRs equal to 189 percent of its initial allocation. Some other major recipients were the Netherlands (65 percent), Canada (46 percent), Austria (30 percent), Germany (28 percent), and Korea (23 percent). Developed nations seemed to have a greater tendency to be recipients of SDRs than did the less developed nations. Of 25 developed nations, 12 recorded net increases in holdings of SDRs; in contrast, only 12 of 79 less developed nations were net recipients of SDRs.

¹⁹In practice, only the *difference* between the charge on a nation's net cumulative allocation of SDRs and the interest on its average holdings of SDRs is paid to or received by a nation. See International Monetary Fund, *By-Laws, Rules and Regulations*, Twenty-Eighth Issue, (Washington, D. C.: October 20, 1969), p. 56.

The major source of receipts of SDRs (other than allocations) was transfers from other participating nations in exchange for convertible currencies. Most of these transfers (totaling 291 million SDRs) were to nations designated by the IMF to receive the SDRs. There were, however, at least six transfers (totaling 181 million SDRs) between participants by mutual agreement. In five of these transactions the United States transferred SDRs; in the other transaction, the United Kingdom was the transferor. The largest of the transfers by mutual agreement occurred on December 23, 1970, when the United States is reported to have sold 110 million SDRs to Belgium in exchange for United States dollars.²⁰

In addition to receipts of SDRs from other participants in exchange for currency, some nations acquired relatively small amounts of SDRs in other ways. Five countries purchased about one quarter million SDRs from the IMF General Account to pay charges and assessments. These five nations had probably already used their entire initial allocations in other transactions. In April 1970, some participating nations received SDRs as interest (net of charges) on their holdings of SDRs. In May, the IMF transferred approximately 18.4 million SDRs in partial payment of interest due to nations that had creditor positions in the General Account.²¹ In September, the IMF paid out 7.8 million SDRs as part of a distribution of net income. Also in September, the IMF General Account replenished its holdings of the currencies

²⁰*The Financial Times* (London), December 31, 1970, p. 5.

²¹The remainder of the interest due was paid in gold and in the currencies of the recipients. Interest paid on creditor positions in the General Account is entirely different from interest paid on holdings of SDRs.

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of 12 countries by purchasing those currencies in amounts totaling the equivalent of almost \$325 million. Three nations elected to receive payments for their currencies in SDRs (totaling 67.5 million SDRs) in lieu of gold.

The General Account does not receive allocations of SDRs. It was, however, both a recipient and a user of SDRs during the first year as a result of some of the previously described operations and transactions of the participants. The General Account was a recipient of SDRs in each of the first 12 months of operation of the Special Drawing Account, and it used SDRs in eight of those months. With gross receipts of almost 389 million SDRs, the General Account had a net holding of over 290 million SDRs at the end of the year. The General Account's holdings of SDRs, 8.5 percent of the total outstanding, were greater than the holdings of every participating nation, except the United States and Great Britain.

CONCLUDING COMMENTS

Eighty-five nations used or received SDRs during the first 12 months of the operation of the Special Drawing Account: 43 were users only; 26 were recipients only; and 16 (including the United States) were both users and recipients of SDRs.

Only 19 participants remained entirely on the sidelines.

At the end of December 1970, only one recipient approached the 300 percent of cumulative allocation limit. That nation, Belgium, held 289 percent of its cumulative allocation. In contrast, 37 participants, 32 of which are categorized by the IMF as less developed, had reduced their holdings of SDRs to less than 30 percent of their initial allocations, raising the question of the need for these nations to reconstitute their holdings. These nations can easily meet the 30 percent average requirement without purchasing any SDRs, however, by merely limiting their use of the allocation received in 1971 and the allocation scheduled for 1972.

It is probably too soon to assess fully the effects of SDRs on world commerce. However, the new reserve facility does carry with it the promise of avoiding the restrictions on international commerce that might result from international competition for shares of an inadequate world stock of reserve assets. If the creation of SDRs does help to avoid the use of undesirable forms of competition for reserves, the substantial efforts that have gone into developing the SDR facility will have been a wise investment for the world.



DIRECT FOREIGN INVESTMENT OF THE UNITED STATES

In recent years, the importance of United States direct investments in foreign countries has received increased attention. The rapid increase in the number and size of United States-controlled foreign firms and the repatriated income from these investments has resulted in an awareness of the role of foreign direct investment. This article reviews the history of United States direct foreign investment and the distribution of direct investment by geographic areas and industry groups. The article is concerned with private direct foreign investment and the repatriated income generated by accumulated direct foreign investment; it does not discuss the other forms of United States foreign investment and mentions only in passing related indirect effects on the economies of the capital exporting and recipient countries. These indirect effects are difficult to measure and are influenced by factors such as the source of the investment funds, the use made of the funds, monetary and fiscal policies, and tariff and trade policies in the countries involved.

Economic growth, which depends to a large extent upon the ability of an economy to increase the quantity of capital goods used in the production of goods and services, can be accelerated through the use of external capital. Thus, the savings of a capital-surplus nation can be used to stimulate the growth process of a capital-short nation. Through this process, European countries contributed significantly to the early growth of

the United States economy. In recent years, and especially since World War II, the United States has been one of the few countries that exported substantial amounts of capital and, at the same time, continually expanded its own domestic investment and production. The United States transferred capital both through government grants and loans and through private investments, largely direct investments.

DEFINING DIRECT FOREIGN INVESTMENT

Direct foreign investment is both a stock and a flow concept. That portion of the assets of foreign business enterprises owned by United States residents represents the existing stock of United States direct foreign investment. From the point of view of the balance of payments, direct foreign investment is the flow of United States capital into foreign businesses in which a United States resident or an affiliated group of residents have or obtain significant control. The capital movements associated with direct foreign investments are viewed as foreign extensions of the management interests of the parent firm in the United States.

For balance of payments purposes, the distinction between long-term investments in foreign equity securities and direct foreign investment is made on the basis of ownership. A foreign investment is considered to be direct if the United States individual or firm owns or obtains more

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than 10 percent of the foreign enterprise.¹ A United States investment in a foreign enterprise is also considered direct if all United States residents together hold 50 percent or more of the voting stock of the firm, even if no individual or affiliated group holds as much as 10 percent.

The outflows of capital included in the direct foreign investment portion of the United States balance of payments account are: (1) United States sources of short- and long-term funds invested overseas by United States parent corporations; (2) transfers by the United States parent corporation to the foreign affiliate (or to foreign residents as compensation for the acquisition of equity interest) of funds that were borrowed abroad by the United States parent or its affiliates; and (3) reinvested earnings of foreign branches of United States corporations. (Such earnings are considered as profits of the parent firm and thus represent an outflow of funds from the United States.²) Items not included in the balance of payments report (although they affect the net worth of the investments) are: (1) reinvested

¹For a more detailed definition of direct foreign investment, see *Dictionary of Economic and Statistical Terms*, U. S. Department of Commerce (August 1969).

²A foreign branch of a United States corporation is considered to be an integral part of the parent firm and earnings of the branch are considered as part of the earnings of the parent firm. Thus, earnings of foreign branches that are reinvested are considered to be an outflow of funds from the United States. In contrast, a foreign subsidiary of a United States corporation is incorporated abroad and is considered to be a separate unit and earnings of this foreign subsidiary are not looked at as earnings of the parent firm. Only dividends and interest remitted to the parent corporation by a foreign subsidiary are considered as income inflows; reinvested earnings of a foreign subsidiary are not considered to be a capital outflow since no transfer of funds takes place between the United States parent firm and its foreign affiliate (subsidiary).

earnings of foreign subsidiaries of United States corporations; and (2) changes in the value of foreign assets that result from political actions abroad. These latter transactions do not involve a transfer of funds between the United States parent and its foreign affiliate.

It is important to distinguish between direct foreign investment and the other forms of private foreign investment, such as bank loans and portfolio investments. A bank loan or credit to a foreigner is generally a financial transaction with no equity interests acquired. Portfolio investments may include the purchase of foreign stocks or bonds by United States residents. Unlike a stock purchase, a bond purchase does not involve an equity interest. Moreover, portfolio investments involving stock purchases are generally smaller in dollar volume than would be required to obtain a controlling interest (10 percent or more) and are not considered to be direct investments.

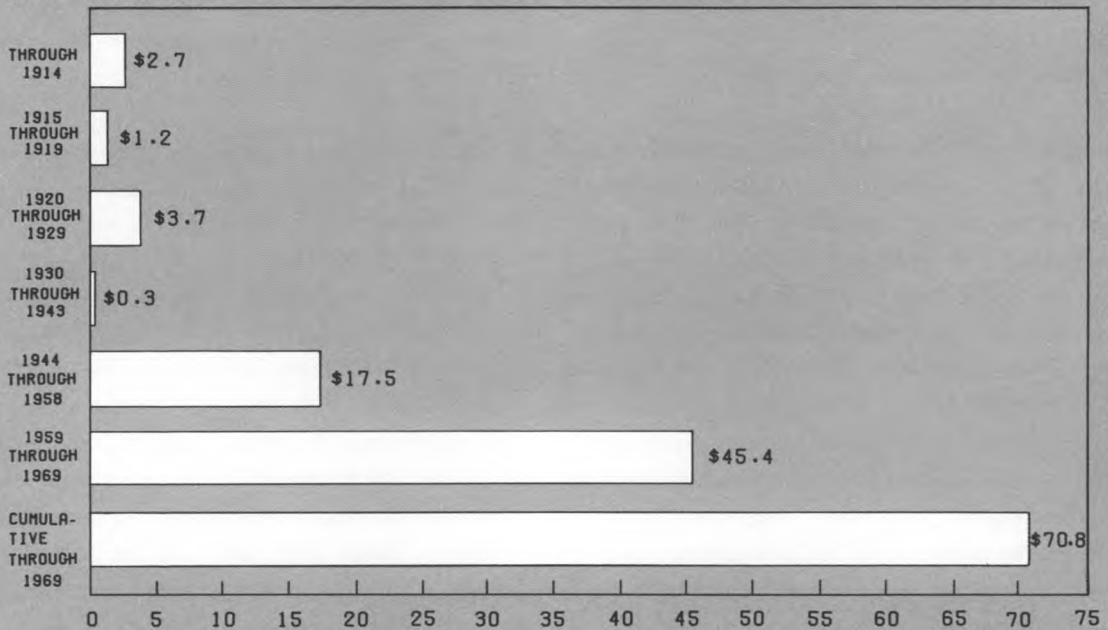
The method of measurement of direct foreign investment used in the United States balance of payments accounts can be confusing with respect to the actual dollar outflow involved in direct foreign investments, because recorded capital outflows do not necessarily involve any dollars leaving the United States. For example, if a parent company ships goods or provides services to its foreign affiliates for credit, the transaction is recorded as a capital outflow, even though dollars do not leave the United States. Also, in parent-branch relationships, foreign branch profits are recorded as an inflow of funds (income) into the United States from direct foreign investments, but the amount of profits actually retained by the foreign branch and reinvested is recorded as a direct foreign investment (outflow of funds). Capital outflows related to direct foreign investments, therefore, may not only involve transfers of

CHART 1.

GROWTH IN BOOK VALUE OF UNITED STATES DIRECT FOREIGN INVESTMENT

1914-1969

BILLIONS OF DOLLARS



SOURCE OF DATA: U.S. DEPARTMENT OF COMMERCE

dollars, but also credits to finance the export of United States goods and services or intra-company book transactions.

HISTORY OF DIRECT FOREIGN INVESTMENT

The United States did not begin to make significant direct foreign investments until late in the nineteenth century. In 1897, the total book value (stock) of United States direct foreign investments was only \$0.6 billion; but by the end of 1914, it reached \$2.7 billion (see Chart 1). Nearly one-half of this investment was located in Latin America; Canada and Europe received the major share of the remainder. By 1929, the book value of direct foreign investment had accumu-

lated to \$7.6 billion. The continued growth in direct foreign investment, to this point in time, showed specific periods of increased activity, such as the original investment in Latin American mining, petroleum, and railroads prior to 1914 and the expansion of these investments that was stimulated by the need for raw materials during World War I. Following World War I, manufacturing holdings were greatly increased, particularly in Canada and Europe, and large investments were made in petroleum, agriculture, and public utilities in Latin America. The accumulation of direct foreign investment ceased during the depression years, when foreign currencies depreciated and investments already made in extractive industries and agricultural production were hard hit by the

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sharp drop in world commodity prices. World War II also kept direct foreign investment at a low level; as a result, the total accumulation in book value between 1930 and 1943 amounted to only \$0.3 billion.

Although United States firms again began expanding abroad soon after World War II, the annual flow of investment funds did not rise above the 1925-1929 average until 1947, nor much above the 1929 level until 1956. The annual outflow of direct investment was restrained by postwar dislocations in Europe, a strong domestic demand for capital, exchange restrictions abroad, and uncertainty about the political and economic future of Europe.

In 1958, 14 countries³ agreed to establish external (for nonresidents) convertibility for their currencies; in the same year, the European Economic Community (EEC) or Common Market was formed by six of these countries.⁴ These events stimulated a rapid advance in United States direct foreign investment, as confidence in the economies of Europe returned. Even more importantly, United States firms sought to establish themselves within the EEC tariff barriers in order to service the growing European market more efficiently.

Between 1958 and 1969, the book value of United States direct foreign investment increased by \$45.4 billion to reach \$70.8 billion at yearend 1969. This total book value of direct foreign

³Austria, Belgium, Denmark, Finland, France, The Federal Republic of Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Sweden, and the United Kingdom.

⁴Belgium, France, The Federal Republic of Germany, Italy, Luxembourg, and the Netherlands. The EEC was formally established by the Treaty of Rome, signed in 1957.

investment is somewhat misleading, because book value does not necessarily represent the market value of these United States foreign assets. Instead, book value is the sum of the value of such assets as carried on the books of the foreign affiliate. They are neither capitalized earnings nor current market values.

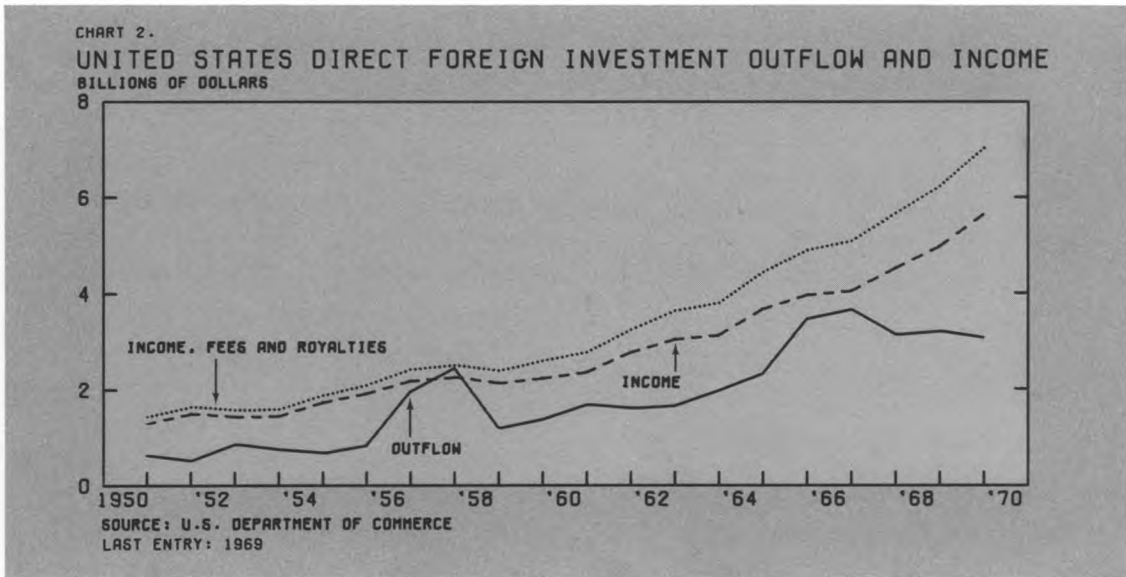
The accumulated book value of \$70.8 billion does not necessarily represent the accumulation of past outflows of capital from the United States. In addition to being financed by funds obtained from parent firms in the United States, additions to book value of affiliates of United States firms are financed by reinvested earnings and the overseas sale of equities.

Direct Foreign Investment Income. The growth of United States direct foreign investment outflows was accompanied by a parallel growth of the inflow of direct investment income.⁵ With the exception of 1957, direct investment income exceeded direct investment outflow in every year during the 1950-1969 period.⁶ If fees and royalties⁷ from direct foreign investments are added to recorded income, the total annual return from accumulated direct foreign investment exceeded annual direct investment outflow even in 1957 (see Chart 2). During the 1950-1954 period,

⁵Income from United States direct foreign investments consists of dividends and interest paid by subsidiaries, branch profits of United States parent firms, and all retained earnings of branches.

⁶The more detailed discussion of developments in direct foreign investment income and outflow is confined to the 1950-1969 period because an upward trend began in income flows during this period while outflows showed some rather sharp fluctuations.

⁷Fees and royalties from direct foreign investments are a separate item in the United States balance of payments accounts and are not included in the item "income from direct foreign investments."



capital outflow for direct foreign investments averaged \$677 million per year, while income from accumulated direct foreign investments averaged \$1,475 million per year, for an average annual surplus of income over outflow of \$798 million per year (see Table I). If fees and royalties from direct foreign investment are added to this average surplus, returns from accumulated direct foreign investment exceeded outflow by an average of \$928 million per year during the 1950-1954 period. The slight decrease in the average annual surplus from direct foreign investments from the 1950-1954 period to the 1955-1959 period was due to the sharp increase in direct investment outflows in 1956 and 1957 and not to a decrease in income derived from accumulated foreign direct investment. The rather slow annual growth of the surplus of direct investment income over outflow from the 1960-1964 period to the 1965-1969 period was also due to above average outflows of direct investment funds during two years of the latter period—1965 and 1966. By 1969, direct

foreign investment income exceeded direct foreign investment outflows by \$2,569 million; if fees and royalties from direct foreign investments are included, the surplus amounted to \$3,938 million.

Income from United States direct foreign investment has proven to be one of the more stable and consistently growing group of receipts in the United States balance of payments. Although other segments of our international accounts have fluctuated substantially in response to economic and political disturbances, income from direct foreign investments has remained an important source of foreign exchange earnings.

Direct Investment Outflow. The aggregate annual capital outflow for direct foreign investment fluctuated widely during the 1950-1969 period but was relatively stable during the 1950-1955 portion of this period (see Chart 2). This stable period was followed by two years of heavy direct investment outflow. Specifically, in 1956 and 1957, United States firms made large foreign petroleum investments, with the purchase

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TABLE I

United States Direct Foreign Investment
Annual Average Outflows and Income
1950-1969
(mil. of \$)

	Annual Average			
	1950- 1954	1955- 1959	1960- 1964	1965- 1969
Capital outflow	\$ 677	\$1,554	\$1,868	\$3,295
Income	1,475	2,136	2,995	4,628
Surplus: Income over Outflow	798	582	1,127	1,333
Fees and royalties	130	244	572	1,151
Total surplus	928	826	1,699	2,484

Source: U. S. Department of Commerce

of oil concessions in Venezuela accounting for a large share. In 1957, \$900 million was added to oil investments in Latin America; \$770 million of this was invested in Venezuela. Oil leases accounted for \$360 million of the \$770 million investment.

After 1957, United States direct foreign investment outflows increased compared with the 1950-1955 period and showed a general upward trend for the remainder of the period under discussion. This trend was stimulated, in part, by the previously mentioned agreement to reestablish convertibility of the major European currencies and by the formation of the Common Market in 1958.

A new phase in international business began in the late 1950's. Until that time, United States direct foreign investment was characterized by an emphasis on investments in petroleum and other raw material extraction projects. Starting in the late 1950's, however, direct foreign investments in manufacturing and trade were steadily increased, and these flows of funds were largely directed to Europe.

The sharp increase in direct investment outflow in 1965 can be attributed to large capital expenditures by United States firms for exploration and

development of oil resources in the Middle East and to a large increase in outflows to Canada to refinance existing credits from the United States of finance and trading affiliates. The 1965 United States-Canadian Auto Products Trade Agreement⁸ also stimulated investment in the transportation equipment industry in Canada, and these investments were reflected in a continued high level of capital outflow in 1966. Earnings of foreign affiliates, particularly in the petroleum industry, leveled off in 1965 and 1966, and the affiliates had difficulties in financing increased working capital needs out of internal funds. As a result, there was an increase in outflows from United States parent firms to meet these working capital needs. Following these two peak years of direct foreign investment outflow, the flow of such funds decreased to slightly more than \$3 billion annually and remained at that level through 1969.

Factors Influencing Investment Flows. The leveling of investment outflows from 1967 through 1969 was the direct result of policy actions taken by the United States. During 1964, the United States became increasingly aware of its continuing balance of payments deficit. Consequently, since 1965, there has been some emphasis on limiting direct foreign investment outflows as part of a program to control the balance of payments deficit. It was assumed that the balance of payments deficits early in the 1960's were temporary; and that if some restraint were placed upon the outflow of dollars in the short-run, the immediate imbalance in the United States international accounts might be overcome, thus gaining

⁸Under the agreement, Canadian autos and parts can be shipped to the United States free of duty, while similar United States exports to Canada are exempt from duty only when prescribed rules for use of Canadian goods and services are met in the manufacture and sale of the automobiles.

time for long-range influences to have an effect on international income and expenditure relationships. Because of the continued book value growth of foreign direct investment through funds borrowed abroad, there was also the belief that income from accumulated past direct foreign investment would continue at a relatively high level during the period that foreign investment outflow was limited. It was assumed that long-range foreign investment income would, therefore, not suffer appreciably.

To this end, in February 1965, President Johnson called for the support of United States business leaders to limit voluntarily their direct foreign investment outflows. In December 1965, the voluntary restraint program was tightened. The leveling off in the outflow of direct foreign investment in 1966 and the reduction in 1967 reflected the cooperation of United States corporations with the voluntary restraint program. By 1968, however, it was deemed desirable, as part of a broader series of balance of payments measures, to reduce the level of direct foreign investment outflow further; therefore, mandatory controls were placed on private capital outflows.⁹ Since these measures were imposed, the outflow of direct foreign investment funds has leveled off at about \$3 billion per year.

OTHER FACTORS IN EVALUATING FOREIGN INVESTMENT

The effects of direct foreign investment on a nation's economy cannot be evaluated solely on the basis of derived income. For example, in countries receiving these investments, the funds

are usually used to establish new production facilities, and additional national income is generated through: (1) wages paid to those employed in the facilities; (2) purchases of locally produced materials; and (3) taxes paid by the employers and employees, as well as from interest and dividends paid to local residents who may have helped to finance the facility. Benefits may also be derived from the managerial and technical skills and product technology that often accompanies the capital flow. On the other hand, the flow of foreign capital may, in part, merely substitute for domestic investment in the recipient country and, to the extent that substitution may take place, no net benefits would accrue to the recipient economy.

Similarly, capital exports in the form of direct foreign investment may increase employment opportunities in the country that is exporting the capital. For example, some foreign investments result in an increase in the volume of United States merchandise exports, such as machinery for a new factory and later raw materials or semi-finished goods for that factory; thus, the level of United States production and income is raised. Moreover, some foreign investments are made for facilities that produce industrial materials needed domestically, and the lack of these supplies could affect the American economy. In contrast, if a foreign direct investment is made to establish a facility to produce a good which is in direct competition with a United States export, the level of exports of that good from the United States may be reduced.

Many problems associated with foreign investments are political, but the same problems would be economic issues if considered in the context of a national economy. For example, if a corporation located in the eastern United States made an investment in production facilities in the West, any

⁹For details of these control programs, see the *1970 General Bulletin*, published in the *Federal Register*, Vol. 35, No. 196, October 7, 1970.

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changes that might occur in either region as a result of this investment would be considered as economic. However, if the same corporation made a similar investment in a foreign country, political questions could arise since the receiving country might consider the investment as an expansion of foreign control of business in the country, and this might be looked at with disfavor. East-West trade restrictions fall into the political (as well as economic) category. The separation of economies by national boundaries, combined with differences in laws, policies, and institutions, complicates an evaluation of the impact of direct investments. Such an evaluation would be relatively simple if considered in relation to a domestic economy.

OUTFLOW AND INCOME BY GEOGRAPHIC LOCATION AND INDUSTRY GROUP

Although the aggregate annual capital outflow of direct foreign investment and the income from this accumulated investment have shown a relatively stable growth pattern, year-to-year fluctuations have occurred in the area and industry distribution of the totals. These fluctuations are the result of a number of causes including: the discovery and development of new sources of raw materials; completion of scheduled investment programs; international agreements, such as the formation of common market areas; and relatively short-term changes in flows connected with such factors as exchange restrictions or changes in exchange rates and interest rate differentials.

Canada. Canada has received the largest volume of United States direct foreign investment. Between 1955 and 1969, the book value of direct investment in Canada grew from about \$6.8 billion to slightly more than \$21 billion—an increase of

212 percent (see Table II). In 1969, the book value of United States direct foreign investment in Canada accounted for about 30 percent of the total book value of all American investments abroad. The annual flow of direct investment funds from the United States to Canada fluctuated widely during the 1955-1969 period, reaching a low of \$302 million in 1961 and a peak of \$1,135 million in 1966. The sharp increase in investment outflow in 1965 and 1966 reflects the stimulus given to potential Canadian auto production by the 1965 United States-Canadian Auto Products Trade Agreement. (The 1965-1966 upswing in direct foreign investment in the manufacturing industry category of Table II also reflects United States investment in Canadian auto production facilities.) Also, capital flows to Canada were exempt from the 1968 mandatory controls placed on direct investment.

As shown in Table II, the annual increase in the book value of United States direct foreign investment in Canada, as well as in the other geographic areas, usually exceeded the annual capital flow from the United States to Canada and the other areas. This reflects the fact that a portion of the capital expenditures by foreign affiliates of United States firms is financed by funds obtained abroad (retained earnings of subsidiaries, foreign borrowing, etc.). Unusually large (or small) direct foreign investment outflows in any one year generally result from special situations in the recipient country (for example, the United States-Canadian Auto Products Trade Agreement).

The relative size of repatriated income from Canada and direct investment in Canada shifted in 1961. Between 1955 and 1960, capital flows to United States affiliate corporations in Canada exceeded income received from these affiliates (see

TABLE II

United States Direct Foreign Investment
Total Book Value, Capital Outflow, and Income
1955-1969
(mil. of \$)

Country and/or Area	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Total world															
Book value	\$19,395	\$22,505	\$25,394	\$27,409	\$29,827	\$32,778	\$34,667	\$37,226	\$40,686	\$44,386	\$49,328	\$54,711	\$59,486	\$64,983	\$70,763
Capital outflow	823	1,951	2,442	1,181	1,372	1,694	1,599	1,654	1,976	2,416	3,418	3,623	3,154	3,209	3,070
Income	1,912	2,171	2,249	2,121	2,228	2,355	2,768	3,050	3,134	3,670	3,963	4,045	4,518	4,973	5,639
Canada															
Book value	6,761	7,795	8,769	9,470	10,310	11,198	11,602	12,133	13,044	13,796	15,223	16,999	18,097	19,535	21,075
Capital outflow	353	601	678	421	417	471	302	314	365	239	912	1,135	403	625	619
Income	293	326	335	315	345	361	464	476	455	634	703	756	790	851	762
Latin America															
Book value	6,031	6,844	7,434	7,773	8,120	8,387	8,236	8,424	8,662	8,894	9,391	9,826	10,265	11,033	11,667
Capital outflow	167	618	1,163	299	218	95	173	- 32	69	143	176	190	184	477	271
Income	672	800	880	641	600	641	730	761	801	895	869	965	1,022	1,049	1,049
EEC*															
Book value	1,773	1,429	1,680	1,908	2,208	2,644	3,104	3,722	4,490	5,426	6,304	7,584	8,444	9,102	10,194
Capital outflow	76	145	96	106	180	282	277	485	588	807	857	1,143	852	438	648
Income	75	70	83	81	134	144	193	247	232	275	366	321	398	434	453
United Kingdom															
Book value	1,427	1,649	1,974	2,147	2,477	3,231	3,554	3,824	4,172	4,547	5,123	5,657	6,113	6,694	7,158
Capital outflow	32	282	172	63	190	589	196	170	124	206	317	381	353	363	284
Income	153	210	173	192	281	217	239	211	199	276	270	251	274	275	327
Other Europe															
Book value	402	483	497	519	639	806	1,084	1,384	1,678	2,136	2,558	2,967	3,369	3,701	4,202
Capital outflow	22	61	19	21	114	91	252	214	217	355	305	285	275	200	226
Income	38	34	26	25	28	35	53	68	76	103	132	157	178	196	246
Rest of world															
Book value	2,725	3,047	3,381	3,710	3,949	4,210	4,649	5,042	5,678	6,390	7,300	8,039	9,082	10,210	11,261
Capital outflow	121	175	149	168	69	102	346	368	419	462	742	443	831	715	631
Income	651	690	709	809	753	872	977	1,126	1,197	1,344	1,428	1,418	1,632	1,951	2,275
Industrial Group															
Mining and smelting															
Book value	2,197	2,419	2,361	2,558	2,848	3,013	3,061	3,183	3,369	3,569	3,785	4,315	4,876	5,435	5,635
Capital outflow	46	116	199	177	231	158	72	91	65	88	98	220	316	383	52
Income	195	239	210	169	249	337	296	314	293	399	443	524	596	645	664
Petroleum															
Book value	5,899	7,355	9,055	9,822	10,324	10,944	12,151	12,661	13,652	14,334	15,298	16,205	17,404	18,887	19,985
Capital outflow	392	1,173	1,408	649	410	455	747	538	810	739	1,013	876	1,103	1,181	1,022
Income	1,026	1,163	1,276	1,169	1,100	1,143	1,303	1,578	1,654	1,922	1,798	1,778	1,989	2,288	2,635
Manufacturing															
Book value	6,623	7,561	8,009	8,673	9,707	11,152	11,936	13,212	14,937	16,931	19,339	22,058	24,167	26,414	29,450
Capital outflow	224	390	432	269	468	802	460	680	716	997	1,494	1,730	1,211	905	1,122
Income	383	375	429	460	549	550	710	741	660	876	1,095	1,118	1,193	1,275	1,325
Other, including trading and utilities															
Book value	4,676	5,169	5,970	6,356	6,947	7,635	7,536	8,089	8,727	9,552	10,932	12,133	13,039	14,247	15,692
Capital outflow	161	273	404	86	262	278	188	248	297	552	766	716	390	556	873
Income	308	394	335	202	330	319	364	417	451	543	625	625	740	776	1,014

p Preliminary.

* European Economic Community.

Source: U. S. Department of Commerce

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Table II). By 1961, however, interest and dividends paid to United States parent firms plus profits of branches of United States corporations exceeded the direct investment outflow to Canadian affiliates. Except for the peak investment years of 1965 and 1966, income from direct investment in Canada exceeded direct investment outflow to Canada every year during 1961-1969. There is, of course, a time lag from when a capital investment is initiated to when returns from the investment begin. Thus, the 1961 shift reflects a buildup of income from past accumulation of investment expenditures in Canada.

United Kingdom. United States firms have also made relatively large direct investments in the United Kingdom. Between 1955 and 1969, the book value of direct investment in the United Kingdom rose from about \$1.4 billion to nearly \$7.2 billion—an increase of 402 percent. Both capital outflow from United States parent firms to United Kingdom affiliates and income from these affiliates fluctuated considerably during the 1955-1969 period. In particular, the sharp increase in direct investment outflow in 1960 reflects the acquisition of a minority interest in an existing automobile manufacturing firm in the United Kingdom. (The increase in capital outflows in 1960 in the foreign manufacturing industry category also reflects this acquisition as well as a general upturn in direct investment in foreign manufacturing facilities.) The decrease in direct investment income from the United Kingdom in 1963 resulted in large part from the heavy use of undistributed profits in place of capital funds from United States parent firms. A large volume of dividend payments scheduled for 1963 was delayed until 1964; the comparatively large increase in direct investment income in 1964 reflects these delayed payments.

Latin America. By 1969, the accumulated book value of United States direct foreign investment in Latin America was second only to that in Canada, when such investment is divided by the geographic areas selected for Table II. However, between 1955 and 1969, the relative growth of book value of direct foreign investment in Latin America (93 percent) was considerably less than that in other geographic areas. Historically, the direct investment emphasis in Latin America has been in the mining, smelting, and petroleum industries. The slower growth in the book value of direct investments in Latin America reflects the general trend toward greater emphasis in recent years on investments in manufacturing industries—directed increasingly toward the industrialized countries.

Purchases of oil concessions in Venezuela had a major influence on the large capital outflow of Latin America in 1957. As mentioned earlier, \$900 million was added to petroleum investments in Latin America in 1957, with \$770 million going to Venezuela. By the end of 1957, the book value of United States direct investments in Venezuela reached \$2.7 billion—nearly one-third of the total for the entire Latin American area. Mining investments in Mexico and Peru also contributed to the large increase in Latin American direct investment in 1957. The sharp drop in direct investment outflows to Latin America in 1960 was largely the result of the cessation of investment flows to Cuba. However, the United States direct investments in Cuba that were seized were not immediately written off. The negative capital outflow to Latin America in 1962 reflects the write-off of the seized Cuban investments.

With the exception of 1957, income from direct investment in Latin America exceeded direct investment outflow in each year during the 1955-1969 period. Income from the Latin

American investments was also considerably larger than from the other geographic areas of the world shown in Table II. A large proportion of direct investment in Latin America is in the petroleum, mining, and smelting industries; the returns from these investments are generally greater than from investments in manufacturing, trade, and utilities. (This fact is also reflected in the substantial income from direct investment in the area category "rest of world" and in the petroleum industry category. Investment in the petroleum and extractive industries represents a large proportion of the book value of direct foreign investment in "rest of world".)

The slowdown in the growth of direct investment income from Latin America that began in 1967 may reflect the influence of several factors: a preceding increase in less profitable manufacturing investments; nationalization of some United States operations in several Latin American countries; the trend toward a larger share of equity interest being held by local residents; and increased taxes and royalty payments by petroleum corporations to host countries.

Common Market. Another area where large United States direct investments have been made is the EEC. The combined book value of investment in the EEC countries increased from about \$1.2 billion in 1955 to nearly \$10.2 billion in 1969—an increase of 769 percent (see Table II). During the five year period 1955-1959, the average annual increase in the combined book value of United States direct investment in EEC nations was \$207 million; this figure rose to \$536 million during the 1960-1964 period and reached an annual average of \$778 million during 1965-1969.

During the period under review, direct investment outflows to the EEC continually exceeded direct investment income. This may reflect the

fact that a large share of the direct investments were made more recently in the EEC than in other geographic areas, and returns on these investments are just beginning to build up. Liberal use has also been made of the retained earnings of EEC subsidiaries for capital expansion, which, in turn, delays income flows to parent firms in the United States. In addition, many petroleum refining affiliates in Europe have traditionally had branch losses.

The large capital outflow to the EEC in 1966 is largely the result of overseas borrowing. That is, because of tight money conditions in the United States and the direct investment control program, domestic corporations borrowed funds through foreign bank loans and other foreign sources. A large share of these funds were transferred to other foreign affiliates and are counted as capital outflows from United States parent firms to their foreign affiliates. (The borrowing is, however, a credit item in the balance of payments accounts and thus has no net effect.) Direct investment outflows to the EEC tended to slacken following the 1966 peak, due in part to the United States Direct Investment Control program (voluntary from 1965 through 1967 and mandatory beginning in 1968).¹⁰ However, the book value of direct investment in the EEC continued to climb because funds from foreign sources were used to finance capital expenditures.

SUMMARY

United States direct foreign investment has increased rapidly in recent years and reached a book value of \$70.8 billion at the end of 1969. This growth was particularly strong in the 1958-1969 period, when \$45.4 billion was added

¹⁰ *Ibid.*

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to the book value. Both direct foreign investment outflow and direct investment income have an important influence on the United States balance of payments. With the exception of only four years (1928, 1929, 1931, and 1957), direct investment income has exceeded direct investment outflow in every year since 1919. In 1969, this surplus of income over outflow amounted to \$2,569 million—a major offsetting item to the depressed merchandise trade surpluses of recent years and to the deficits resulting from continued high foreign military expenditures and private short-term capital flows. If fees and royalties from direct foreign investment (not included as direct investment income in the balance of payments accounts) were included, the excess of income

over outflow would have amounted to \$3,938 million in 1969.

Late in the 1950's, there was a decided shift in the area and industry distribution of United States direct foreign investment. Until the immediate post-World War II period, direct foreign investment had been concentrated in the extractive and petroleum industries, with heavy investments being directed toward Latin America and Canada. After the late 1950's, the emphasis shifted to investments in manufacturing, and an increasing volume of such investment funds was directed toward Canada and western Europe. Large direct investments, however, continued to be made in foreign petroleum facilities, particularly in the Middle East and Venezuela.



SPECIAL ANNOUNCEMENT

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