New Foreign Bond Issues in the U.S. Market

by ROBERT F. GEMMILL

DURING 1962 U.S. INVESTORS purchased nearly $1 billion of new foreign dollar bonds —the largest volume in any year since the 1920's. And they increased their rate of purchases in early 1963.

The U.S. capital outflow on new foreign bond issues since the mid-1950's has reflected a continuing strong foreign demand for external capital and a growing supply of U.S. funds available for investment in such issues.

More broadly, this outflow has reflected the position of the United States as the leading international capital market. This position is based upon the accessibility of the U.S. market to all borrowers, foreign and domestic, and upon the large volume of savings, including foreign savings, that flow into this market for investment in dollar securities.

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Before 1958, issues of the International Bank for Reconstruction and Development and Canadian issues accounted for almost all of the outflow of capital on new securities. In the past 3 years a steady growth in non-Canadian bond issues has increased their relative importance in the outflow.

Bond issues of the IBRD and of some Canadian provinces, municipalities, and private concerns are regarded in investment circles as comparable to high-grade U.S. corporate bonds. The volume of these foreign issues has fluctuated, and the timing has been influenced by some of the same factors that affect offerings of domestic bonds in the United States.

Bond issues of other foreign countries have a wide range of investment characteristics. Such issues have continued to offer high yields. In view of this and of a spreading investor awareness of the growing financial strength of leading industrial countries, they have attracted an increasing volume of U.S. capital from a growing number of investors.

Correlation studies do not reveal a close relationship between U.S. capital market conditions and dollar bond issues by foreign countries other than Canada. Nevertheless, some evidence suggests that U.S. investor interest in these bonds may be slightly greater when capital market conditions in the United States are easy and the yield advantage of foreign bonds over domestic bonds is large. Yields on foreign dollar bond issues (excluding those of Canada) have remained high in the face of increased investor interest, and yields and costs of borrowing have fluctuated little in response to changing conditions in the U.S. capital market.

Given the strong capital demands of borrowing countries, there is little indication that potential borrowers are deterred to any great extent by increases in borrowing costs in the U.S. market of the size that have occurred in recent years. So long as there are restrictions—actual or potential—on borrowing by nonresidents in foreign capital markets, even relatively small-scale foreign borrowers seeking external funds are likely to find it advantageous to maintain close relations with the U.S. capital market. And for large-scale borrowers the financing alternatives available are quite limited.

Some borrowers, however, are clearly prepared to shift part of their capital requirements from the United States to markets in third countries, when access to such markets is permitted.

In this article, the term "foreign issues" includes privately placed as well as publicly offered securities. It also includes securities offered to refund existing debt. An outflow of U.S. capital occurs when any of these issues are purchased by U.S. residents, but not when they are purchased by foreigners.

INTERNATIONAL INSTITUTIONS

Bond issues of international institutions in the U.S. market consisted solely of IBRD issues until December 1962, when there was an issue by the Inter-American Development Bank. As shown in Table 1, much of the variation in total capital outflows on foreign bond issues between 1956 and 1961 reflected fluctuations in IBRD borrowing.

Individual offerings by international institutions have been large—generally $75 million or more—and have carried offering yields very close to those on the highest grade U.S. corporate bonds. The high investment standing of such bonds is in part attributable, particularly during the early years of operation of the respective Banks, to the large capital subscriptions of the United States. These subscriptions are subject to call by the Banks when required to meet obligations created by borrowing.

The underwriting spreads on IBRD and IDB issues have been small. The costs to the Banks of borrowing on new issues in the U.S. market have generally exceeded the yield to the investor by less than 0.1 of 1 per cent per annum. Some IBRD issues have sinking fund provisions, generally designed to retire about half of the issue by maturity. The IDB issue provided for the retirement of almost the entire issue before maturity.

TABLE 1

CAPITAL OUTFLOWS ON NEW FOREIGN ISSUES IN THE U.S. MARKET

(In millions of dollars)

Area or institution	1954	1955	1956	1957	1958	1959	1960	1961	1962
Total	**309**	**128**	**453**	**597**	**885**	**624**	**573**	**510**	**978**
International institutions	88	...	...	187	366	14	97	12	159
Total foreign countries	**221**	**128**	**453**	**410**	**519**	**610**	**476**	**498**	**819**
Excluding Canada	54	89	78	86	152	173	249	274	376
Excluding Canada and Israel	**14**	**47**	**25**	**38**	**105**	**121**	**198**	**216**	**316**
Western Europe	..	29	...	25	51	78	24	57	143
Latin America	...	4	...	...	14	...	107	18	20
Sterling area	14	14	25	13	40	21	52	76	70
Other	...	...	...	...	...	22	15	65	83
Canada	167	39	375	324	367	437	227	224	443
Israel	40	42	53	48	47	52	51	58	60

NOTE.—Based on U.S. Dept. of Commerce balance of payments data, except that the following amounts of stock issues are excluded: $50 million European and $20 million Japanese issues in 1962 and $70 million European issues in 1958.

Bond issues by the IBRD were heavy in 1957 and 1958 when the Bank was building up its short-term investments to levels in excess of its commitments for disbursements. Since then the Bank has been able to obtain a large share of its funds through sales from its loan portfolio and through bond issues outside the United States, both in dollars and in foreign currencies. But it has continued to issue bonds in the United States occasionally—most recently in January 1962—as a means of maintaining its relations with the U.S. market.

The net outflow of U.S. capital through IBRD issues is probably little affected over a period of a few years by capital market conditions in this country, but the timing of the issues within this period is apparently influenced by variations in market conditions, as is true for high-grade domestic corporate bonds.[1] The Bank has offered its recent issues when capital market conditions here were easing. Similarly, the IDB bond issue, which was floated well in advance of that Bank's requirements for funds, came when interest rates here appeared attractive.

CANADA

Capital outflows to Canada on new issues were particularly heavy in the 1956-59 period. Then, through mid-1962 they dropped off to about half the peak rate of 1959. But Canadian offerings rose sharply last fall and remained large in early 1963.

New Canadian issues comprise a wide range of securities of different characteristics, as is the case with domestic issues. The variety of Canadian securities offered in the U.S. market reflects the close relationships of the two capital markets, as well as the close financing relationships of private corporations in the two countries.

Bond issues of Canadian provincial governments and large municipalities generally carry Aa or A investment ratings, and they may range in size from $25 million to $75 million. They carry yields close to those on similarly rated U.S. corporate bonds and are floated at small underwriting spreads.

Other Canadian issues include bonds of smaller local governments and bonds and stocks of private corporations, ranging from large established business concerns to newly formed companies. These issues are often much smaller than those of the provincial bonds, and yields on them—in general—are considerably higher and underwriting spreads considerably wider than in the case of high-grade provincial and municipal issues. These same characteristics are found in U.S. issues of lesser investment standings.

The Canadian Government had not borrowed in the U.S. market for a number of years until last year when it arranged for a $250 million loan from several U.S. insurance companies. This loan was drawn in two *tranches,* in late 1962 and early 1963.

Variation in the volume of Canadian bond issues in the U.S. market since the mid-1950's has reflected both exchange rate developments and expectations and interest differentials. The influence of these factors can be seen in the Canadian data given in Table 2 and in the chart on page 590.

The data cover all Canadian publicly issued bonds and all known private placements in Canada and abroad, including some that were not publicly announced. The data

[1] For results of a correlation study, see Philip Bell, "Private Capital Movements and the U.S. Balance-of-Payments Position," *Factors Affecting the United States Balance of Payments,* Joint Economic Committee, Congress of the United States, U.S. Government Printing Office, 1962.

on issues in foreign currencies represent primarily issues in the United States. Because the U.S. balance of payments data include outflows resulting from stock issues, the Canadian data, which are limited to bond issues, supply a useful indication of the factors affecting issues of Canadian bonds in the U.S. market.

Role of exchange rates. Table 2 shows the influence of exchange rate expectations on the volume of foreign currency borrowing by Canadian provincial and local governments and companies. Canadian borrowings in foreign currencies dropped substantially in mid-1960, following a marked depreciation of the Canadian dollar earlier in the year and a warning by Finance Minister Fleming in his spring budget message of the exchange risks to Canadians of borrowing in foreign currencies. Such borrowings by provincial and local governments fell off very sharply and remained at a very low level through mid-1962.

In the autumn of 1962, several months

TABLE 2

BOND ISSUES OF CANADIAN PROVINCES, MUNICIPALITIES, AND CORPORATIONS

(Amounts in millions of Canadian dollars)

Quarter	All issues			Interest rate spread[1] (basis points)	Provinces and municipalities			Corporations		
	Total amount	In foreign currency			Total amount	In foreign currency		Total amount	In foreign currency	
		Amount	Per cent of total			Amount	Per cent of total		Amount	Per cent of total
1956— I	468	118	25	45	217	96	44	251	22	9
II	510	132	26	54	263	82	31	247	50	20
III	461	164	36	65	228	98	43	233	66	28
IV	587	136	23	66	284	46	16	303	90	30
1957— I	657	225	34	82	293	95	32	364	130	36
II	764	245	32	85	251	56	22	513	189	37
III	344	131	38	83	213	65	31	131	66	50
IV	567	69	12	31	380	40	10	187	29	16
1958— I	517	142	27	51	259	83	32	258	59	23
II	761	241	32	68	395	151	38	366	90	25
III	419	81	19	75	226	41	18	193	40	21
IV	545	53	10	90	374	40	11	171	13	8
1959— I	462	144	31	89	362	135	37	100	9	9
II	373	72	19	74	234	65	28	139	7	5
III	513	172	34	74	408	145	36	105	27	26
IV	540	142	26	80	397	123	31	143	19	13
1960— I	555	149	27	96	317	118	37	238	31	13
II	684	110	16	104	453	75	17	231	35	15
III	486	21	4	99	340	12	4	146	9	6
IV	368	19	5	113	274	5	2	94	14	15
1961— I	560	62	11	130	403	20	5	157	42	27
II	594	111	19	127	323	26	8	271	85	31
III	624	66	11	99	432	3	1	192	63	33
IV	598	26	4	95	466	10	2	132	16	12
1962— I	484	4	1	87	356	....	....	128	4	3
II	716	143	20	103	414	2	....	302	141	47
III	382	49	13	142	256	36	14	126	13	10
IV	727	183	25	124	540	131	24	187	52	28

[1] Spread between long-term bond rates in Canada and the United States (Canada minus United States) as published in *International Financial Statistics* (International Monetary Fund). A basis point is 0.01 of 1 per cent.

NOTE.—Gross amounts as published by Bank of Canada.

after the Canadian Government had adopted a fixed exchange rate, foreign currency borrowing by provincial and local governments in the U.S. market was resumed on a substantial scale. This resurgence of borrowing reflected the rapid spread of confidence in the newly established par value for the Canadian dollar. It also reflected an indication by the Canadian Government that it favored an increase in the volume of borrowing from abroad; this included the arrangement of the $250 million loan by the Government itself, mentioned above.

Foreign currency borrowing by Canadian corporations fluctuated after mid-1960. It was relatively high in the first 3 quarters of 1961 and again in the second and fourth quarters of 1962. The different foreign borrowing practices of Canadian corporations and provincial and local governments may reflect different requirements for funds and different alternative sources of financing. Some corporations have close financial ties with the U.S. capital market. Some also have substantial foreign exchange earnings, and they may be quite willing to assume obligations payable in foreign currencies. Moreover, Canadian provincial and local governments may be more susceptible to "moral suasion" by the Dominion Government.

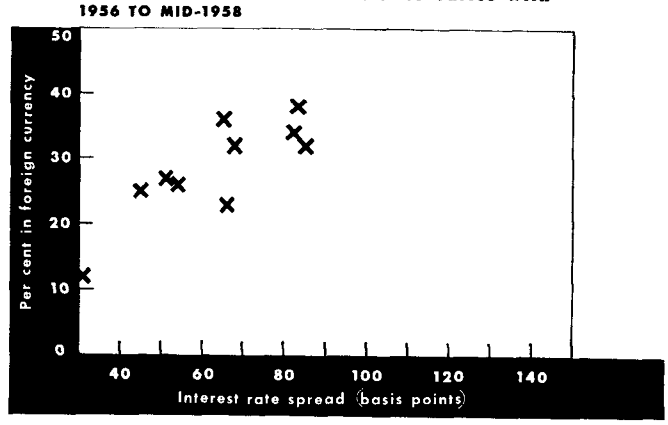
Interest rate differentials. The accompanying chart shows the extent to which foreign currency borrowings by Canadian provincial and local governments and companies have reflected interest rate differentials in three recent periods. From 1956 to mid-1958 the proportion of total Canadian issues in foreign currencies varied directly with the extent to which long-term interest rates in Canada exceeded those in the United States. The relationship was much closer for corporate borrowing than for borrowing by provincial and municipal governments.

For the period from mid-1958 to mid-1960, there was no discernible relationship between interest differentials and the share of Canadian issues offered in foreign currencies. Throughout most of this period long-term interest rates were rising sharply in both the United States and Canada; in fact, they reached their postwar peaks in early 1960. Rising rates were accompanied by a decline in total Canadian corporate bond issues and corporate issues in foreign currencies, while issues by provinces and municipalities increased.

This shift in the relative importance of different classes of borrowers may explain in part the lack of any visible relation between interest differentials and the proportion of Canadian issues in foreign currencies. The adjustments made by Canadian borrowers in their financing plans in response to high and rising interest rates may also be part of the explanation. The proportion of total borrowings in foreign currencies averaged a little lower in this period than in the preceding one.

CANADIAN BORROWING HERE sometimes varies with

1956 TO MID-1958



NOTE.—Data are those shown in Table 2. A basis point is 0.01 of 1 per cent.

Beginning in mid-1960 a relationship somewhat resembling that of 1956-58 appears to have been reestablished. However, the proportion of foreign currency issues was much smaller for each level of the rate differential during this period than was true earlier. This may be explained by borrowers' recognition of an increased foreign exchange risk after mid-1960.

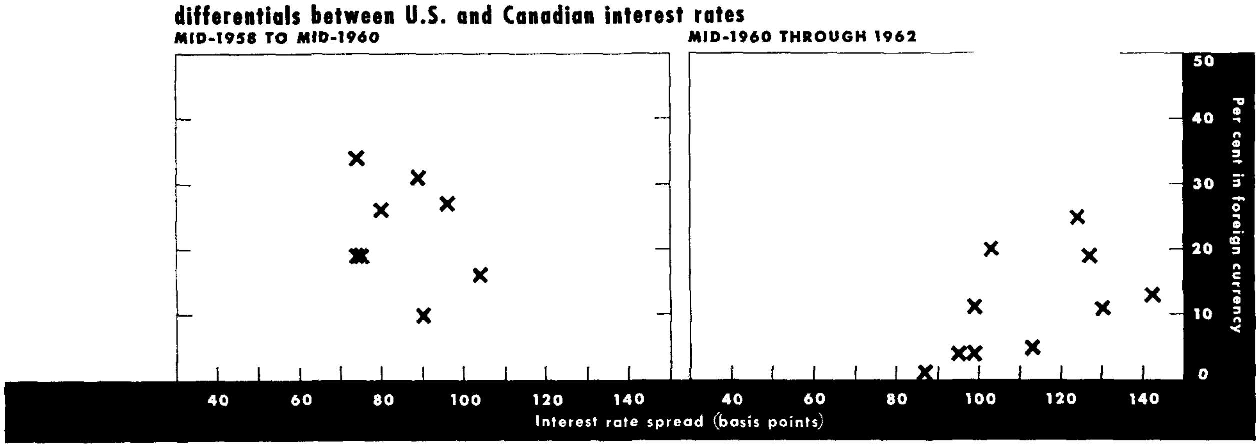
The smaller proportion of foreign currency borrowing and the relationship between such borrowing and interest rate differentials can be seen more clearly if the data for the second and fourth quarters of 1962 are separated from the other data. (These data are identified in the chart.) In the second quarter foreign currency issues were dominated by a single $100 million offering by a major Canadian corporation, and the upsurge in the fourth quarter occurred after the Canadian Government had established a par value for the Canadian dollar and had directly encouraged Canadian borrowing in the United States, both through financial policies and official statements and through its own borrowing.

There are several reasons why one should not expect an extremely close correlation between interest differentials and foreign currency borrowings. The distribution of bond issues by time periods is undoubtedly characterized by some lumpiness.[2] Once a major borrower has sold a large new issue, he is unlikely to need to make another offering even if the interest differential widens shortly after his flotation. Furthermore, bond issues must be negotiated and scheduled well in advance of offering dates, particularly when capital market demands are strengthening. And finally, yield differentials on outstanding issues are not likely to be an entirely suitable index of relative costs of new issues.

On the other hand, some of the apparent shifting from Canadian to foreign currency borrowing observable in the chart may result

[2] See; Gerald K. Helleiner, "Connections Between United States' and Canadian Capital Markets," *Yale Economic Essays*, Vol. 2, p. 382.

differentials between U.S. and Canadian interest rates



from shifts in the proportion of total Canadian borrowing by particular Canadian borrowers. Some may rely more regularly than others on the U.S. market for funds.

In general, the evidence indicates that Canadian bond issues in the United States are influenced by interest differentials between the two markets as well as by exchange risks. These differentials probably reflect changes in Canadian financial policies and market conditions more than changes in U.S. market interest rates.

But the total volume of these issues, as well as their timing, is also influenced by other factors. In particular, the size and underwriting capability of the U.S. market attracts some Canadian borrowers. Moreover, issues offered in the U.S. market may attract funds from Canadian investors.

OTHER FOREIGN COUNTRIES

The gradually rising trend in capital outflow on bond issues by other foreign countries since 1957, illustrated in Table 1, reflects growth in the number of foreign borrowers as well as more frequent appearances of some borrowers in the U.S. capital market.

The most regular borrower in this group has been the Government of Israel, for which separate figures are shown in the table.

The outflow of U.S. capital on these Israeli issues has been stable, and because they have not been affected by changes in capital market conditions or by other factors that influence foreign bond issues generally, these issues are excluded from all of the following discussion.

Bond issues of other foreign countries have consisted almost entirely of obligations of central governments or semiofficial institutions. But a few large private companies in Europe and Japan have also been issuers.

Bond issues by foreign governments have provided investors with yields that often range from 1 to 2 percentage points above those on new issues of U.S. corporate bonds of the highest quality (see Table 3). Underwriting costs on these issues are high—frequently 2½ per cent of the amount of the issue, which is equivalent to a cost of ¼ to ⅜ of 1 per cent per annum above the offering yield. Other expenses of new foreign issues apparently absorb from 0.2 of a per cent to more than 1 per cent of the amount of the issue.[3]

Virtually all issues have sinking fund provisions designed to retire most or all of the issue by maturity. These provisions shorten the average maturity and provide substantial support for the market price of the issue throughout its life.

One notes a striking difference between the development of foreign borrowing in recent years and the findings of Ilse Mintz with respect to such borrowing in the 1920's.[4] There is no evidence in recent new bond issues of the deterioration in quality of foreign bond issues that she demonstrated to have occurred then. Most countries that have borrowed in the U.S. market recently have low external indebtedness, and many have experienced both rising reserves of gold and foreign exchange and sustained economic growth.

Foreign demands. Some foreign governments were initially encouraged to float issues in the U.S. market or other accessible markets by the policy of the IBRD. The Bank has made loans to some countries in conjunction with a bond issue in the private capital market by the borrowing country.

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[3] See E. Nevin, "Reflections on the New York New Issue Market," *Oxford Economic Papers,* Vol. 13, No. 1, Feb. 1961, p. 87.

[4] Ilse Mintz, *Deterioration in the Quality of Foreign Bonds Issued in the United States 1920-1930,* National Bureau of Economic Research, 1951.

But more generally, the need to develop access to large-scale sources of funds has encouraged foreign governments and private companies to offer bonds in the United States. The absorptive capacity of the U.S. market is several times that of any other financial center.

Moreover, the U.S. market is open to all borrowers, foreign or domestic. The practice of some European countries of limiting or closing their markets to outsiders, often on an intermittent basis, tends to reduce the incentives for those who borrow often to rely to any large extent on these markets for capital.

Market conditions and foreign demands. One major question with respect to foreign bond issues is whether they respond to the forces that influence the domestic bond market. In particular, do foreign demands reflect the influence of changes in long-term interest rates in the United States?

Yields and costs. Yields on new bond issues of foreign governments and/or governmental agencies have consistently exceeded those on new issues of highest grade U.S. corporate bonds, and often by as much as 1 to 2 percentage points, as Table 3 shows. In periods of relatively stringent capital market conditions, offering yields on foreign bond issues in the U.S. market have risen much less than those on new U.S. corporate issues. And in periods of relatively easy capital market conditions, yields on foreign issues have fallen less. Thus, offering yields on foreign issues have changed less in response to changing market conditions than yields on U.S. domestic issues.

Another reason why the costs of foreign issues vary less is that the higher underwriting costs on these issues and other costs associated with such issues add a larger and

TABLE 3

SELECTED FOREIGN BOND ISSUES IN THE U.S. MARKET

(Amounts in millions of dollars; yields and cost in per cent)

Month and year	Amount	Bond yields			Cost to borrower
		Foreign issue	New U.S. corporate	Difference	
	Australia				
6–'56....	25	4.64	3.56	1.08	4.89
3–'57....	20	5.00	4.18	.82	5.24
4–'58....	25	4.85	3.67	1.18	5.09
10–'58....	25	5.20	4.48	.72	5.41
9–'59....	25	5.76	5.29	.47	5.98
4–'60....	25	5.46	4.78	.68	5.67
9–'60....	25	5.42	4.45	.97	5.63
6–'61....	25	5.75	4.65	1.10	5.98
1–'62....	30	5.65	4.45	1.20	5.87
6–'62....	30	5.71	4.15	1.56	5.93
10–'62....	25	5.58	4.23	1.35	5.80
4–'63....	30	5.20	4.21	.99	5.40
	Belgium				
9–'57....	30	5.75	4.68	1.07	6.03
11–'61....	25	5.70	4.32	1.38	5.96
3–'62....	30	5.40	4.23	1.17	5.65
	Denmark				
2–'59....	20	5.75	4.29	1.46	6.03
5–'62....	20	5.47	4.09	1.36	5.74
2–'63....	30	5.37	4.15	1.22	5.64
	European Coal and Steel Community				
4–'57....	25	5.50	4.23	1.27	5.68
6–'58....	35	5.24	3.61	1.63	5.48
10–'60....	25	5.63	4.60	1.03	5.84
5–'62....	25	5.33	4.09	1.24	5.54
	New Zealand				
11–'58....	10	5.62	4.35	1.27	5.91
10–'61....	20	6.01	4.26	1.75	6.27
5–'62....	25	5.50	4.09	1.41	5.75
	Norway				
9–'58....	18	5.45	4.56	.89	5.70
5–'61....	18	5.75	4.51	1.24	6.02
7–'62....	20	5.85	4.33	1.52	6.12
4–'63....	25	5.42	4.21	1.21	5.68
	Oslo				
5–'58....	8	5.75	3.66	2.09	6.06
6–'60....	10	5.85	4.69	1.16	6.16
4–'62....	10	5.70	4.17	1.53	6.00

NOTE.—Yields on corporate bonds in the United States are averages based on new offerings of issues for the month rated Aaa through A, adjusted to an Aaa basis by the First National City Bank. Yields and costs for new foreign issues are from Moody's Investors Service. Cost to borrower differs from offering yield by the underwriting spread; does not include other costs of flotation.

essentially unchanging element.[5] Evidence of the relative stability of costs to foreign borrowers can be found in Table 3. Declines in costs and yields on several issues in early 1963 resulted in part from large foreign participation, which reflected confidence in the dollar. The countries listed are those whose governments have borrowed most often in recent years.

But even if the costs that foreign countries pay to borrow in the U.S. market are not very responsive to changing market conditions, there is still a question whether the range of variation that borrowers may expect is large enough to influence the decisions of these countries to borrow. The answer can be determined only on a case-by-case basis.

The evidence suggests that in many instances the changes in these costs that have occurred in recent years have not been large enough per se to affect foreign demands for U.S. funds to any great extent. The explanation appears to lie in the fact that borrowing countries have not been able to meet their large demands for external capital from any other market than in the United States. The governments and other borrowers of these countries in many instances have evidently been willing to pay 6 per cent or more per year for U.S. capital.

Two examples. Recent offerings by some Scandinavian countries and by Australia seem to substantiate this point. Norway was willing to borrow $18 million in the U.S. market at a cost of 6 per cent in 1961, although reportedly it had borrowed the equivalent of $12 million in Switzerland at a cost of about 5 per cent in 1960.[6] Similarly, the Copenhagen Telephone and Telegraph Co. (a company partly owned by the government) was willing to borrow $15 million in the United States in May 1962 at a cost of 6¼ per cent, on an issue not shown in the table, although it had obtained the equivalent of $7 million on an issue with a 4¾ per cent coupon floated in the Netherlands the previous year.

Although these Scandinavian borrowers took advantage of lower (or at least apparently lower) European rates when issues in Europe were possible, they were prepared to pay higher interest costs in New York when necessary.

Aside from Canada, Australia is probably the largest single borrower in foreign security markets. When possible, it has borrowed at a cost of 5½ per cent or less both in the United States and abroad. But it has also borrowed at 5¾ per cent through its recent $100 million loan from the IBRD and at almost 6 per cent through issues here in 1961 and 1962.

The amount that Australia has borrowed in particular foreign markets apparently depends in large part on the availability of funds in those markets. Since early 1958 it has borrowed more than $250 million through the U.S. market. It has borrowed an even larger amount in the United Kingdom during this period, but most of these issues have been to refund maturing bonds. Australia also borrowed the equivalent of $60 million through several issues offered in

[5] Parenthetically, it may be noted that the underwriting spreads are reported to be higher for foreign issues in the New York market than for foreign bond issues in London. In addition, new foreign issues in New York apparently involve additional costs to the borrower, among which are expenses incurred by the underwriter in sounding out the potential market for the bonds and the legal expenses of arranging an issue. Nevin, *op. cit.*, p. 85.

Nevin concludes that "New York is an extremely expensive market in which to borrow." *Op. cit.*, p. 105.

[6] See *International Financial News Service*, Nov. 11, 1960.

Switzerland, in the Netherlands, and in Canada. These issues, which were floated in 1960 and 1961, carried yields to the investors ranging from 4.5 per cent in Switzerland to 5.9 per cent in Canada. The borrowing cost on the issue in Canada doubtless exceeded such costs on Australian issues in the U.S. market.

Australia's demonstrated requirements for foreign capital seem to indicate that modest increases in long-term interest rates affect no more than a small margin of its demand for U.S. capital.

Supplies of funds. Foreign issues in the U.S. market attract funds from both U.S. and foreign investors. In fact, the U.S. capital market has become a focal point for the investment of foreign capital. The managing underwriter of a foreign issue offered in the U.S. market often arranges a selling group comprising leading banks and dealers in the major European countries. This group supplements the distribution of bonds in this market by the U.S. underwriting syndicate. According to a prominent investment banker experienced in U.S. underwriting of foreign issues:[7]

> From the distribution standpoint, the functioning of a European selling group has often been more effective than the underwriting group . . .
>
> By taking advantage of this New York investment banking mechanism, a foreign government or foreign private company is able to raise money in the United States and in six or seven European countries simultaneously. The issuer thereby taps European markets which may not be open at the moment convenient to it, and also thereby raises larger sums than would be available to it in any one of these European markets. While only one or two million dollars may be available in one country to an issuer at a given moment, New York has proved a more convenient market than any other in which the issuer could raise these sums in several countries in one operation.

Purchases of foreign dollar bonds by foreign investors do not, of course, represent a capital outflow from the United States. But they have contributed to the continuing development of the U.S. capital market as the principal center for international lending.

Foreign investors have found foreign dollar bond issues attractive because they are denominated in dollars and because yields on foreign governments' dollar issues are often higher than those on bonds of the same governments issued in their domestic markets and denominated in national currencies. In one notable instance, a foreign government provided a special incentive to ensure that an issue of dollar bonds was held by U.S. investors.[8] Furthermore, interest on foreign dollar bonds is not subject to the U.S. income tax when the bonds are held by aliens who are nonresidents.

U.S. investors have been increasingly attracted by the yields on foreign bond issues. In earlier years, investor interest was stimulated in part by IBRD studies of and loans to countries making public bond issues. More recently, and especially since currencies of major European countries have been made convertible, this factor has been less important than the demonstrated financial strength of the industrial countries that are borrowers.

[7] Nathaniel Samuels, "The Investment Banking Background of Issuing and Marketing Foreign Securities in the United States." Address delivered at a conference on legal problems of international financing at the Yale Law School, Mar. 1-3, 1962, pp. 3, 4.

[8] "One interesting example of an offering being tailored to American buyers to increase their interest in foreign bonds was the direct placement of $25 million Kingdom of Belgium 5¼ per cent bonds in 1959. As long as these bonds are held by the original or other approved U.S. investors, they earn an extra ¾ of 1 per cent or a total of 6 per cent per annum. If held by nonapproved investors only the regular coupon rate of 5¼ per cent is paid." Andrew N. Overby, "Resurgence of Foreign Borrowing in the U.S.," *Commercial and Financial Chronicle*, Vol. 192, No. 1006, Nov. 24, 1960, p. 26.

While U.S. investor interest in foreign dollar bond issues has been growing, this development has been gradual. Again, according to Nathaniel Samuels:[9]

> Many major insurance companies remain well under their [legal] ceilings [for foreign bonds as prescribed in State laws], and those that have made a real effort as yet to reach for theirs are few. Pension funds, particularly those administered by commercial banks, have perhaps been the most conservative in buying foreign securities, although this is rapidly changing.

Effect of changing market conditions on supply. Changing capital market conditions in this country affect capital outflows on foreign bond issues if they influence the extent to which U.S. investors purchase these issues. One approach to testing this influence is to look at the proportions of U.S. participation relative to the volume of new issues in different periods. Table 4 provides data on new issues by European borrowers.

TABLE 4

U.S. PARTICIPATION IN EUROPEAN DOLLAR BOND ISSUES

(Amounts in millions of dollars; yield in per cent)

Quarter	Total amount	U. S. participation: Amount	U. S. participation: Per cent of total	Yield on new U. S. corporate issues
1957—I	....	....	....	4.20
II	35	17	49	4.48
III	30	9	30	4.68
IV	....	....	....	4.44
1958—I	15	3	20	3.74
II	71	17	59	3.65
III		25		4.27
IV	42	6	14	4.42
1959—I	39	15	38	4.32
II	52	34	65	4.72
III	22	18	82	4.94
IV	50	11	22	5.11
1960—I	3	3	100	4.86
II	12	3	25	4.74
III	....	....	....	4.57
IV	35	18	51	4.66
1961—I	15	14	93	4.31
II	32	23	72	4.53
III	....	....	....	4.53
IV	37	20	54	4.32
1962—I	50	35	70	4.40
II	138	89	64	4.10
III	20	15	75	4.25
IV	4	4	100	4.15

NOTE.—Total new issues include all public offerings and those private placements on which public information is available. U. S. participation is from balance of payments data published by the Dept. of Commerce, adjusted as noted in Table 1. Offering yields are quarterly averages on new issues of high-grade corporate bonds; for source, see NOTE to Table 3.

These data seem to corroborate the thesis that U.S. participation in foreign issues in the U.S. market may rise when markets are relatively easy and yields on new issues of U.S. corporate bonds (and presumably on other alternative investments) are declining or relatively low, and that they may fall when markets are becoming tighter and yields on new issues of U.S. securities are near or at peaks.

Thus, when yields on new domestic issues rose from the second to the third quarter of 1957, the relative share of U.S. participation in European issues declined. And in the fourth quarter of 1958 it was lower than it had been earlier in the year when markets were easier.

The capital outflow to Europe in the third quarter of 1958 represented an offering by the European Coal and Steel Community at the beginning of the quarter. The U.S. yield figure to be compared with this particular outflow is the June-July average (3.73 per cent) rather than the third-quarter average (4.27 per cent) shown in the table.

Data for 1959 show relatively high U.S. participation in European bond issues in the second and third quarters of the year, when markets were tightening and rates rising to postwar peaks. However, this evidence does not necessarily contradict the hypothesis that less easy market conditions tend to deter participation in foreign issues. Several major European issues in the first 3 quarters of 1959 had special features that distinguished them from most foreign bonds and may have

[9] *Op. cit.*, p. 9. More recently, several large insurance companies are reported to have come close to their ceilings.

made them particularly attractive to U.S. investors.[10]

Finally, after U.S. market conditions eased following their late 1959 and early 1960 stringency, and long-term interest rates receded from their highs of that period, relative U.S. investor participation in European issues increased in late 1960 and 1961.

Participation in individual issues. These illustrations seem to support the proposition that U.S. participation in foreign issues varies with capital market conditions. But the evidence would be more convincing if it could be shown that the variation in U.S. participation does not primarily reflect different investor appraisals of, and preferences for, the issues of different foreign borrowers. In general, however, such differences in investor appraisals and preferences are a normal attribute of a dynamic market process.

For example, U.S. investor participation in ECSC issues appears generally to have been higher than in Belgian issues, and correspondingly European participation in the latter appears to have been larger. It was noted earlier that the ratio of U.S. participation in European issues declined from the second to the third quarter of 1957. This may simply have reflected the fact that a $35 million ECSC issue accounted for European borrowing in the second quarter and a $30 million Belgian issue for borrowing in the third.

Because the appraisals and preferences of U.S. and foreign investors regarding bonds of particular issuers may affect relative U.S. investor participation in foreign issues in a given period, a supplementary indication of variations in U.S. supply conditions is desirable.

An alternative approach. Another way of judging the influence of changes in market conditions on the supply of U.S. capital for foreign issues is to infer shifts in the supply schedule from changes in the actual total amounts supplied by U.S. investors. Some foreign issues in the U.S. market are postponable. If the supply of U.S. funds for foreign issues is variable to a significant degree, underwriters of foreign issues would doubtless adjust the flow of these issues in response to changes in market conditions. Thus, changes in the total, rather than in the relative, participation of U.S. investors in issues might provide an indication of changes in supply conditions in the U.S. market.

As shown in Table 1, the supply of U.S. capital for foreign non-Canadian bond issues has risen in each year since 1958. The increases were largest in 1960 and in 1962—both years in which U.S. capital markets were easing.

The substantial increases in foreign non-Canadian issues in these 2 years may have resulted in part from the responsiveness of supply to capital market conditions.

In neither of these instances is it feasible to make a quantitative estimate of the responsiveness of supply. But, after allowance for the long-term trend of growth of investor interest in foreign issues, the increases in supply which could be attributable to shifts in capital market conditions appear modest.

CONCLUSION

Different types of foreign bond issues in the U.S. market are influenced in different ways by changes in capital market conditions. Foreign issuers' demands for U.S. capital are

[10] Two corporate issues—one in the first quarter of 1959 and one in the third quarter—both carried rights for conversion into stock. They may have attracted investors not normally interested in foreign fixed-interest securities. Likewise, the Belgian private placement in the second quarter carried special incentives for U.S. investors (see footnote 8).

more likely to be affected by changes in market conditions when the foreign bond has investment characteristics closely resembling those of high-grade U.S. corporate bonds. In that case, the cost to the foreign borrower may fluctuate with changes in U.S. interest rates. And if the foreign demand for U.S. capital can readily be postponed, the foreign issue may be withheld until capital market conditions are favorable.

The timing of bond issues of the IBRD and the IDB appears to have been influenced by capital market and interest rate conditions. But over a number of years the total volume of U.S. borrowing by these Banks is probably determined by over-all capital requirements and the need to maintain relations with the U.S. market, if one assumes variation in market conditions of the sort experienced in recent years.

Canadian bond issues in the United States have at times shown the influence of relative costs of borrowing in the United States and Canada as well as the effects of changes in exchange risks. These issues appear more affected by interest differentials, and thus by Canadian financial policies, than by changes in U.S. market conditions.

Yields and borrowing costs on other foreign bond issues have been well above those on high-grade corporate bonds and have fluctuated relatively little in response to changes in capital market conditions in the United States. Thus, no more than a small margin of the demands of these foreign issuers is apparently affected by changes in market conditions of the sort experienced in recent years.

The supply of U.S. capital for these high-yielding foreign bonds may be influenced by market conditions, increasing as the yield advantage on them rises. But this effect on the supply of capital is apparently not large in relation to the total volume of new foreign bond issues.