Fed study casts doubt on tracking of capital flows.
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WASHINGTON, April 16 (Reuters) - A recent study by Federal Reserve researchers casts doubt on the U.S. government's system of tracking flows of capital across country borders, raising the possibility the nation's international trade and investment gap is not as bad as thought.

"In some cases - such as foreign holdings of U.S equities and U.S. holdings of foreign bonds - our aggregate estimates were quite accurate, suggesting that capital flows data accurately portray cross-border transactions. But in other cases - notably foreign holdings of U.S. bonds and U.S. holdings of foreign equities - we found great discrepancies between our estimates and actual holdings, suggesting some problems with capital flows data," wrote the study's authors, Francis Warnock and Chad Cleaver.

The study was published on the Fed's Web site last week.

The question of the accuracy of estimates of U.S. financial claims on foreigners, and vice versa, has become more important with the continued rise of the U.S. current account deficit, the broadest measure of cross-border trade in goods, services and investment. The current account gap continued to balloon in recent years, leading many analysts to argue it cannot be sustained. At the very least, they argue, by having such a large reliance on capital from international investors, the U.S. economy could be at risk should confidence overseas be shaken and foreigners' money withdrawn quickly.

One of the main sources for international capital flows is the Treasury Department's Treasury International Capital reporting system, which releases figures on a monthly basis on net sales or buys of U.S. assets by foreigners and vice versa.

But the Warnock and Cleaver paper argues that that data suffers from what they call a "geographic mismatch" - the inference that some of the countries listed are also where the holders of a particular security live. Instead, they argue that the rise of financial centers, such as those in London and in the Caribbean, where investors keep their securities in custody accounts, may be skewing the figures.

"If end-2000 U.S. holdings of foreign securities were underestimated by 10 percent and foreign holdings of U.S. securities were overestimated by 10 percent - not inconceivable amounts given our analysis - the U.S. position as a net debtor was overstated by about $600 billion, or over 30 percent," the authors wrote.

If that were true, it could ease concerns about the United States' ability to maintain the current account gap.

In a March appearance before a Capitol Hill panel, Federal Reserve Chairman Alan Greenspan said the current account gap could not grow indefinitely, but he also admitted he had been unsuccessfully forecasting it to narrow for five years.

But U.S. Treasury Secretary Paul O'Neill has downplayed the importance of the current account gap, saying it reflects investors' beliefs in the potential returns for investing here.

After a speech in Washington in late March, O'Neill said, "Part of the reason I'm not worried about the so-called
current account deficit is because I'm a great believer in the idea that money should go where it's treated well."