

Still A Debtor Nation

Interpreting the New U.S. International Investment Data

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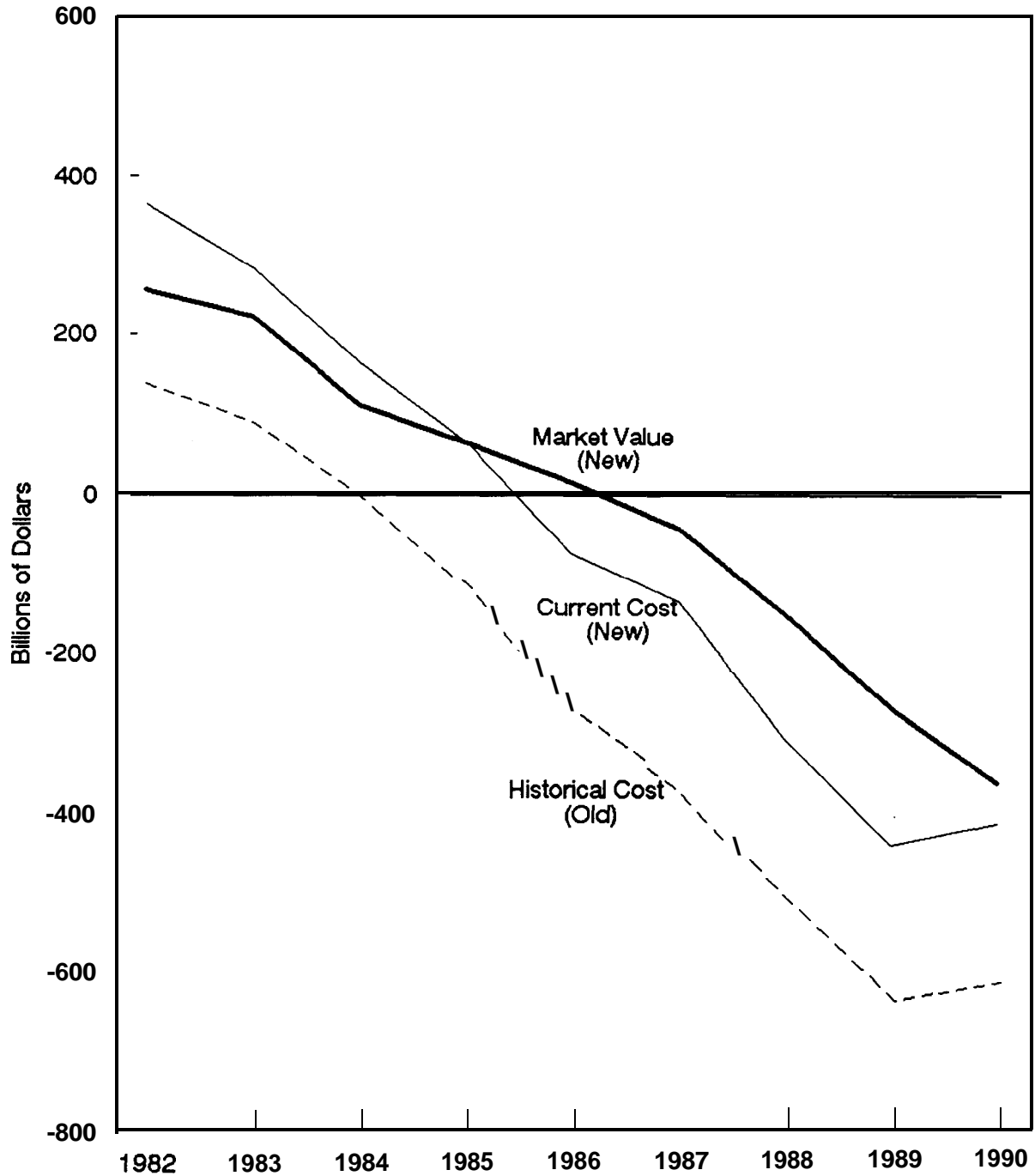
Introduction

In response to criticisms by private economists,' the Commerce Department's Bureau of Economic Analysis (**BEA**) has revised its method of calculating the U.S. Net International Investment Position (NIIP). New estimates for 1982-89 released on June 9, 1991 seemed to imply that the U.S. was much less of an international debtor than was previously thought. When the new methods were extended to the data for 1990, in estimates released on July 2, 1991, however, the result was only confusion. The **BEA** reported that one of its two new measures of the NIIP improved by \$27.5 billion in 1990, while the other one worsened by \$92.9 billion!

This Briefing Paper will explain how the **BEA** revised its measures and discuss what they imply for our understanding of the United States' net debtor status. This paper will show that the parts of the NIIP which have been revised are not the parts which reflect our true net debt position, as the term "debt" is normally understood. Neither of the new measures changes the extent to which the U.S. increased its net *financial* liabilities to the rest of the world in order to pay for the trade deficits of the 1980s.

Moreover, as a glance at Figure 1 will indicate, both new measures show that the overall **trend** of the NIIP is still very much *downward*, even though these new measures make the *level* of the NIIP look higher, and even though one of the new measures (along with the old measure) shows a slight upturn in

Figure 1
U.S. Net International Investment Position,
Alternative Measures, Year-End 1982-90



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

1990. Nothing in the revised estimates changes the fact that the United States went from having a large net creditor position at the beginning of the 1980s to being the world's largest net debtor at the beginning of the 1990s.

In addition, there are some special problems with the data for 1990 which account for the apparent improvement in the NIIP in that year by the old historical cost measure and the new current cost measure. Both a temporary fall in the value of the dollar at the end of 1990 and the enormous statistical discrepancy in the U.S. balance of payments for 1990 make these apparent improvements dubious. In fact, it is likely that *the true NIIP for 1990 should be about \$60 billion lower by any measure*, implying a continued downward trend.

The Revisions

In order to understand the meaning of the revised data, it is important to understand what is being measured. The NIIP equals the difference between the nation's international assets and its international liabilities. In the **BEA's** terminology, this is the difference between "U.S. assets abroad" and "Foreign assets in the United States." Both categories include very diverse types of assets. The three main types of assets **are**:

- (1) direct investment (tangible assets such as property, plant, equipment, and inventories, owned by U.S. multinational firms abroad, or by foreign multinational firms in the U.S.);
- (2) U.S. *official gold reserves* (the value of the gold held by the U.S. Treasury: this is the only U.S. asset for which there is no corresponding foreign asset in the NIIP); and
- (3) *portfolio investments* (stocks, bonds, loans, bank deposits, foreign currencies, and other assets owned by U.S. residents abroad or by foreign residents in the U.S.).²

Most of the **criticisms** of the old NIIP calculations focused on the valuation of the first two **types** of assets, and it was only these two types of assets for which the **BEA** revised its methods. However, it is the third category, *portfolio* investments, which most closely reflects the net debts to foreigners incurred by the U.S. to finance its trade deficits of the past decade,

Under the old method, direct investment was valued at historical cost (book value). That is, the value of U.S.-owned facilities abroad and **foreign**-owned facilities in the U.S. were both valued at the prices at which they were acquired in the past (net of depreciation). This created a distortion, however, because U.S. firms tend to own production facilities abroad which are older than foreign-owned facilities in the U.S. For example, a Ford plant in Europe or a General Motors plant in Brazil would be valued at the prices of the 1960s or **1970s**, when those plants were built, while Honda and Nissan plants in the United States would be valued at the prices of the **1980s**, when they were built. Since price levels have risen dramatically due to inflation, both at home and abroad, this procedure greatly exaggerated the value of foreign direct investments in the U.S. relative to U.S. direct investments abroad.

Also, U.S. gold **reserves** were valued at the 1973 **official** price of \$42.22 per fine troy ounce. However, the market price of gold soared to about \$600 per fine troy ounce at the end of 1980, and has fluctuated between \$300 and \$500 per fine troy ounce since that **time**.³ Thus the old method grossly undervalued the official U.S. gold position in the 1980s by a factor of about ten.

In contrast, the old measures of *portfolio investments* had no special valuation problems (aside from the adequacy of the underlying reporting, which will be discussed further below). Most of these assets and liabilities were already measured in current values, and those measured at historical values were mainly items which would be hard to revalue at current prices (such as bank loans).

The only parts of the NIIP which the **BEA** revised are (1) direct investment and (2) gold reserves. But it was (3) *portfolio investment-the part which has not*

been revised-which accounted for most of the decline in the U.S. NIIP in the 1980s. To see this point, consider the data reported in Tables 1, 2, and 3.

Tables 1 and 2 show the NIIP for 1990 and for 1982, the earliest year for which the data have been revised, respectively. Table 3 shows the changes in the NIIP and its components between these two years. In all three tables, the "historical cost" column shows the old NIIP data. The new data consist of two alternative measures. The "current cost" series measures direct foreign investment at replacement cost: what it would currently cost to build (or replace) the existing assets (after accounting for depreciation). The "market value" series measures direct foreign investment by the stock market value of U.S. and foreign companies* equity in their foreign affiliates.⁴ Thus the market valuation reflects both intangibles such as firm reputation as well as general economic factors which influence stock market prices. Both of the new series measure gold stocks at current market prices.

Measure	Historical cost (Old)	Current cost (New)	Market Value (New)
Direct Investment	17.8	132.1	183.7
U.S. Official Gold Reserves	11.1	102.4	102.4
Portfolio Investment	-646.7	-646.7	-646.7
Total	-617.9	-412.2	-360.6

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, "U.S. Net International Investment Position, 1990." unpublished release, July 2, 1991; and author's calculations.

Note: Totals may not add exactly due to independent rounding.

Table 1 shows that the negative net investment position for 1990 is reduced by about one-third in the current cost series (-412.2 compared with -617.9 billion dollars) and by about two-fifths in the market value series (-360.6 compared with -617.9 billion dollars). Thus it appears that the U.S. was less in debt in 1990. However, all of this improvement comes from the revaluation of gold stocks and of direct investment to current cost or market value (which are the same for gold). Our **net financial debt is unaffected by these changes**, as the nation was still \$646.7 billion in the red in terms of portfolio investments which were not revalued. The excess of stocks, bonds, and other financial instruments owned by foreigners in the U.S. over those owned by U.S. residents abroad is exactly the same in the new measures of the NIIP as it was in the old.

	Historical Cost	Current Cost	Market Value
Direct Investment	83.1	200.8	95.3
U.S. Official Gold Reserves	11.1	120.6	120.6
Portfolio Investment	42.5	42.5	42.5
Total	136.7	363.9	258.4

Sources: U.S. Department of Commerce, Bureau of Economic Analysis. data published in Scholl (1990) and Landefeld and Lawson (199 1): and author's calculations.

Note: Totals may not add exactly due to independent rounding.

Table 2 shows that, when the BEA's new methods are applied to the 1982 data, it turns out that the United States was more **of a net creditor nation at that** time than it appeared to be under the old method. The positive NIIP of 1982 is nearly three times as high by the current cost measure, and almost twice as high by the market value measure, as it was by the historical cost measure. Again, the entire difference is attributable to the revaluation of direct investment and gold reserves. The U.S. had a small net creditor position on portfolio investment in 1982 which is not affected by the revisions. The gold reserves were nearly 11 times higher at current market prices than at the official price. And the direct investment position was more favorable under the new measures-more than twice as favorable at current cost, but only slightly more favorable at market value. This discrepancy reflects the depressed values of stock prices at the end of 1982, which was a year of severe global recession.

Since the new measures of our asset position were higher than the old measure in 1982 as well as in 1990, it follows that the upward revision in the level does not necessarily eliminate the large decrease in this position over the intervening eight years, Indeed this is the case, as the calculations in Table 3 show.

In fact, the new current cost series shows the *largest decrease* of any of the three measures, a fall of \$776.1 billion, which is very close to what the old historical cost measure shows (\$754.6 billion). The market value measure shows only a slightly smaller decrease of \$619.0 billion. The market value measure of the total NIIP falls less because the *direct* investment position actually rose by \$88.4 billion at market values, due to the generally rising tendency of foreign stock prices from 1982 to 1990 (in spite of a notable decline in 1990), and the fact that foreign stock prices generally rose faster than U.S. stock prices in the 1980s (Landefeld and Lawson, 1991, p. 45). It was these changes in stock market prices, not anything involving actual new international investments, which accounts for the somewhat rosier picture painted by the market value data.

Table 3 Changes in U.S. Net International Investment Position, 1982 to 1990 (in billions of dollars)			
Measure	Historical Cost (Old)	Current Cost (New)	Market Value (Old)
Direct Investment	-65.3	-68.7	+88.4
U.S. Official Gold Reserves	-0.1	-18.2	-18.2
Portfolio Investment	-689.2	-689.2	-689.2
Total	-754.6	-776.1	-619.0

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, data published in Scholl (1990). Landefeld and Lawson (1991), and "U.S. Net International Investment Position, 1990," unpublished release, July 2, 1991; and author's calculations.

Note: Totals may not add exactly due to independent rounding.

Of course, the decrease in portfolio investment is *exactly* the same under the old and new measures of the NIIP, since these investments were not revalued. This decrease in portfolio investment of \$689.2 *billion from* 1982 to 1990 accounts for most of the decline in the overall *NIIP* under *all* three measures. And as we shall see, even this **figure** probably understates the increase in the U.S. net financial debt through 1990.

The Anomalies of 1990

While the long-term trends in all three NIIP measures are clearly downward, two of the measures (including one of the new ones) turned slightly upward in 1990 while the third (the market value measure) continued sharply downward (see Figure 1, above). This section will try to explain why the

Commerce Department's measures went in different directions in 1990, and to assess what the true trend in the NIIP really is.

All three NIIP measures, including the old historical cost series, contain certain valuation adjustments for each year. One of these adjustments was especially significant in 1990: the adjustment for exchange rate changes. The U.S. dollar fell in value throughout 1990, ending the year at close to a record low against most other major currencies. As the dollar fell, foreign currencies rose, implying that U.S. *assets abroad (both direct and portfolio) were worth more in dollar terms for any given value in foreign currency at year end 1990 compared with year end 1989.* Thus there was a large positive adjustment to the dollar value of U.S. assets abroad, about \$44.5 billion in the current cost measure and \$36.4 billion in the market value measure. This positive adjustment was large enough to more than offset the *measured* net capital inflows for calendar year 1990, which were only about \$28.6 billion (more on the reliability of this figure below).

In the case of the market value measure, however, there is an additional adjustment which went in the other direction. Due to the declines in the Japanese and European stock markets in 1990—which were larger than the decline in the U.S. stock market in that year—the market value of U.S. direct investment abroad (foreign affiliates of U.S. corporations) fell relative to the market value of foreign direct investment in the U.S. (U.S. affiliates of foreign corporations).⁵ This led to a negative price adjustment of \$98.7 billion in the NIIP at market value, large enough to more than outweigh the positive exchange-rate adjustment of \$36.4 billion. This explains why the NIIP continued its downward trend in the market value series even though it turned slightly upward in the other two series.

These large and varying adjustments raise the question of what future trends are **likely** to be. In regard to the exchange rate, it must be remembered that the dollar was near a record low at the end of 1990, partly as a result of the uncertainties surrounding the then-unresolved Persian Gulf crisis. As of

mid- 1991, the dollar has already recovered most of the ground it lost in the second half of 1990. If present trends hold up, the dollar is likely to end 1991 higher than it began the year, especially if there is an economic recovery in the United States. Thus the positive exchange-rate adjustment for 1990 will probably be reversed in 1991.⁶

In regard to the stock market, it is much harder to make any predictions even for the short run. Nevertheless, it appears that many foreign stocks became overvalued in the boom of the late 1980s (especially in Japan), implying that at least some of the fall in foreign stock prices in 1990 was really a market correction. This implies that the market value measure was really overstating the positive U.S. direct investment position (and understating the negative total NIIP) at the end of 1989,' and that the market value measure for 1990 is more accurate. The market value measure of the NIIP will not be revalued upward again unless there is either a major stock boom abroad (but not in the U.S.) or else a stock market crash in the U.S. (but not abroad).

Finally, as mentioned earlier, the measured net capital inflows into the United States for 1990 were only \$28.6 billion. This low figure, which holds down the decreases in all three measures of the NIIP, is *almost surely an underestimate*. The U.S. balance of payments shows a current account deficit of \$92.1 billion in 1990.' Conceptually, all of this deficit should be exactly matched by net capital inflows. However, only \$28.6 billion of net capital inflows were recorded in the capital account of the balance of payments, leaving *a statistical discrepancy of \$63.5 billion*. This far exceeds the previous record statistical discrepancy, which was \$36.6 billion in 1982 (a year of major capital flight out of Latin America). The \$63.5 billion discrepancy is also larger than the claimed increase of \$27.5 billion in the current cost measure of the NIIP.

While there are problems with the reporting of all international transactions, the current account figures are undoubtedly more reliable than the capital account figures.' This suggests that most of the \$63.5 billion statistical discrepancy is probably accounted for by *unrecorded capital inflows*.

Thus the true *NIIP for* 1990 by any measure is probably *about* \$60 billion lower than *it* appears in the *official BEA* calculations. In this respect, even the small improvements in the NIIP at historical and current costs in 1990 are probably the results of mismeasurement rather than a genuine improvement in the U.S. net investment position.

How Much Do We Really Owe?

It is apparent from the disparity among the three measures of the U.S. NIIP, including the two new ones (which differ as much from each other in some respects as they do from the old one), that there is no single number that can truly summarize the United States' position as a net creditor or debtor to the rest of the world. Nevertheless, it is possible to draw some conclusions from the trends in the available data.

None of the revisions to the data on direct investment and gold reserves should obscure the fact that the U.S. had to borrow almost \$700 billion *more* from the rest of the world than it lent to the rest of the *world* between 1982 and 1990. This is the import of the decline of \$689.2 billion in the portfolio investment position, *a figure* which is not *affected* by the revised estimation methods. And this is not even counting the giant statistical discrepancy for 1990, which along with previous discrepancies would push this figure to over \$800 billion.”

The revaluations of other types of assets do not change the fact that the U.S. had to borrow this amount. First, the revaluation of the gold reserves merely puts a more accurate price tag on the gold in Fort Knox (or wherever the Treasury keeps it). Since we do not use that gold to pay our bills, its greater current market value does not imply lesser net *financial* obligations to other countries. In fact, as the tables show, although the value of the gold reserves was much higher in both 1982 and 1990 at current market prices than it was at

the historical (official) price, its value actually *fell* slightly over that eight-year span as gold prices came down.

Similarly, a more accurate portrayal of the actual value of the direct foreign investment position does not detract from the significance of our increased financial borrowing. In particular, the \$88.4 billion rise in the U.S. direct investment position at market value from 1982 to 1990 is due entirely to the boom in the stock prices of existing U.S. equity abroad in the late 1980s, a boom which was only partly offset by the stock price declines of 1990. This is *purely* a paper gain., which can be wiped out in a stock market crash just as rapidly as it rose in the boom. Indeed, even the \$183.7 billion net direct investment position at market value for 1990 is \$90.6 billion *lower* than it was in 1989 (\$274.3 billion), precisely because foreign stock markets fell by more than the U.S. stock market in 1990.

More importantly, this rise in the market value of the U.S. direct investment position does not help us to pay for our increased *financial obligations* to other countries, such as interest and principal on U.S. Treasury securities, or interest and withdrawals on bank deposits held by foreigners. Whereas an individual is able to sell a business interest in order to pay off a debt, the United States government cannot sell off the foreign affiliates of U.S. companies in order to help service its debt to foreigners.” However, the U.S. government could and perhaps should tax the foreign income of U.S. corporations more in order to help solve its budget *deficit*, as well as to discourage U.S. companies from moving abroad.

An honest and sensible discussion of the policy options facing this country depends on a clear picture of what has happened to the U.S. economy in the past decade. The new Commerce Department NIIP data can help to focus this discussion, if they are properly interpreted and if their limitations are recognized. They reveal that our net direct foreign investment position is still significantly positive, in spite of the rise in foreign direct investment in the U.S. in the past decade. But the new data do not imply that we have borrowed any

less from the rest of the world to pay for the trade deficits of the past decade. These conclusions should lead us to question whether our trade policies should focus on gaming advantages for U.S. companies investing abroad (which seems to be the Bush administration priority in the GATT and U.S.-Mexico Free Trade Agreement negotiations), rather than on inducing U.S. (as well as foreign) companies to produce goods in the U.S.

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Endnotes

1. See especially Ulan and Dewald (1989) and Eisner and Pieper (1990).
2. For present purposes, this category is defined to include all official reserve assets and liabilities other than U.S. gold reserves—in other words, all the parts of the NIIP which were not revalued in the new measures. Other U.S. official reserve assets include Special Drawing Rights (SDRs), the U.S. reserve position at the International Monetary Fund (IMF), and foreign currencies held by the Federal Reserve. Foreign official assets in the U.S. are composed mainly of U.S. treasury securities held by foreign central banks, which should be included in the U.S. portfolio investment position anyway. The other foreign official assets in the U.S. and U.S. official reserve assets are relatively small and do not have an appreciable net impact on the total portfolio investment calculation.
3. The London price of gold per fine troy ounce was \$589.50 at the end of 1980 and \$366.00 at the end of 1990, according to IMF, *International Financial Statistics*, 1990 Yearbook, p. 67 and May 1991, p. 46.
4. Firms' equity in their foreign affiliates should not be confused with ownership of stock in foreign companies, which is counted under portfolio investment. As the Commerce Department economists explain, "The major difference is that portfolio investments are composed of frequently traded securities, whereas U.S. and foreign affiliates are often wholly owned subsidiaries and their stock may not be publicly traded" (Landefeld and Lawson, 1991, p. 45). The Commerce Department's method assumes "that revaluation of direct investment using general stock price indexes produces on average a reasonable estimate of the aggregate value of affiliates in a country" even when equity in those affiliates is not publicly traded (same source).
5. In the market value measure of the NIIP, the value of U.S. affiliates abroad is measured by foreign stock price indexes, while the value of foreign affiliates in the U.S. is measured by a U.S. stock price index. See Landefeld and Lawson (1991).
6. However, in the long run the dollar may have to fall further in order to help eliminate the U.S. trade deficit. This could imply future positive exchange rate adjustments later in the decade.
7. At year end 1989, the direct investment position was a positive \$102.3 billion at current cost and a positive \$274.3 billion at market value, while the total NIIP was negative \$439.7 billion at current cost and only negative \$267.7 billion. These figures may be contrasted with those in Table 1.

8. All balance of payments data here are taken from the US. International Transactions tables in U.S. Congress, Joint Economic Committee, *Economic Indicators*, June 1991.

9. To be sure, there are many imports and exports of goods and services, including factor payments, which go unrecorded, including illegal transactions such as drug imports. But it is far easier to hide money coming into the country to buy assets (e.g., real estate or bank deposits) than it is to hide merchandise.

10. The cumulative statistical discrepancy for 1982-89 is \$113.7 billion.

11. Individual U.S.-based corporations can take cash flow out of their foreign operations (or else leverage their foreign equity) in order to service their own financial obligations to foreign banks or bondholders. But this does not help other U.S. corporations or the U.S. government to service their debts to foreign creditors (except to the extent that the U.S. government could tax foreign profits of U.S. firms more than it currently does).

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