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Why the US Current Account Deficit is Sustainable¹

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I. Introduction

Over the last couple of years, the burgeoning of the US current account deficit, reaching \$792 billion in 2005 alone, has led to significant concerns about the future of the United States and the possibility of a major global crisis. With a brief respite in 1991, it comes after twenty-four years of unbroken deficits, which have totalled over \$5.2 trillion. According to some doomsayers, once the massive financing required to continue paying for such a widening gap dries up, perhaps because foreigners become satiated from owning such a large and rapidly growing amount of American debt, there will be an ugly adjustment in the world economy. The dollar will collapse, triggering a stampede away from American debt, interest rates will shoot up and a sharp global recession will ensue. Martin Wolf (2004) calls the current situation an ‘unsustainable *black hole*’ and points out that ‘The US is now on the comfortable path to ruin’. Maurice Obstfeld and Kenneth Rogoff (2005) remark that ‘any sober policy maker or financial market analyst ought to regard the US current account deficit as a sword of Damocles hanging over the global economy’. Even more dramatically, Nouriel Roubini and Brad Setser (2004) claim that ‘The current account deficit will continue to grow on the back of higher and higher payments on US foreign debt even if the trade

¹We thank Federico Dorso for research assistance.

deficit stabilizes. That is why sustained trade deficits will set off the kind of explosive debt dynamics that lead to financial crises’.

However, if this is such an open and shut case, why has there been no crisis yet? Why is the world willing to lend continuously to the United States and to do so at such low interest rates? Why do markets not react to the wisdom that is being so generously given to them? One possibility is that the March of Folly is an inevitable feature of human hubris and it is the role of the dismal scientist to act as a modern day Jeremiah.

Let us look at the facts. The Bureau of Economic Analysis (BEA) indicates that back in 1982, the United States had about \$329 billion of net foreign assets (which is the difference between the foreign assets owned abroad and the local assets owned by foreigners). These assets rendered a net return of about \$35 billion. Between 1982 and 2005, the United States accumulated a current account deficit of \$5.27 trillion. You would expect the net foreign assets of the United States to fall by that amount, to say, *minus* \$4.94 trillion. If it paid 5% on that debt, the net return on its financial position should have moved from a surplus of \$35 billion in 1982 to *minus* \$247 billion a year in 2005. After all, debtors need to service their debt.

So let us look at how much the actual return on the US net financial position is. The number for 2005 is still a *positive* \$17.6 billion! The United States has spent \$5.27 trillion more than it has earned (which is what the cumulative current account deficit implies) basically for free!

In fact, this inconsistency between the two series seems to have built steadily over the last two decades. Figure 1 makes the point by showing that the US net income flows (the return earned on its net foreign assets) have remained relatively constant, in spite of a persistent accumulation of current account deficits. (Also shown is BEA’s measure of US net foreign assets that roughly moves with the cumulative current account, although it occasionally diverges from it.) It is the inconsistency between the income data and the stock data that has led us to think about the nature of the sustainability of US imbalances from a different angle. But before plunging into our approach, let us see what the official explanation is.

The official story Bill Cline (2005) has argued that there is ‘something misleading about calling a country that makes money on its financial position the world’s largest debtor’. So how can this discrepancy be explained? Part of the answer is that the United States has benefited from what the BEA estimates to be about \$2.25 trillion of net capital gains so that instead of owing \$4.94 trillion, it owes ‘only’ \$2.69 trillion. Figure 1 shows that these capital gains can be sizable. For example, during the 2000–05 period, the net foreign asset position of the US deteriorated by \$1.3 trillion in spite of current account deficits that totalled \$3.26 trillion, the difference being made up by capital gains of about \$2 trillion.

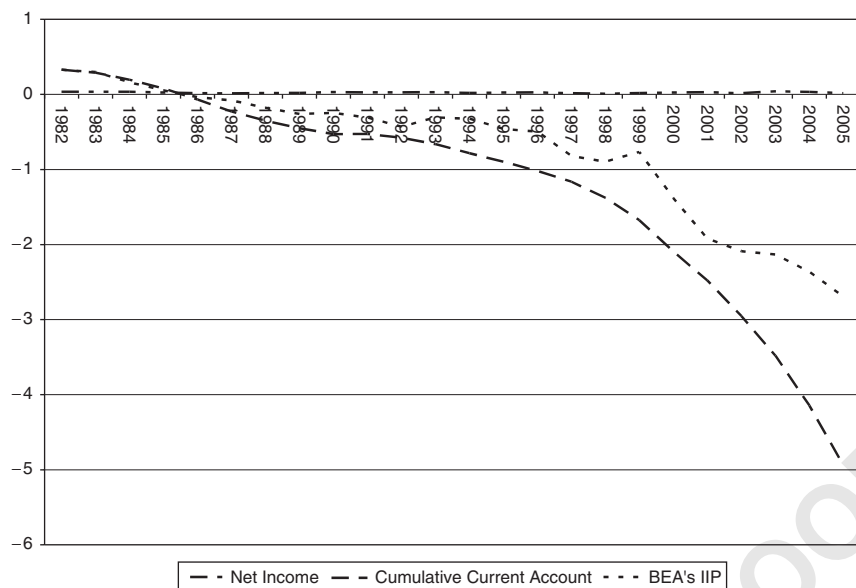


Figure 1: United States Current Account and its International Investment Position (in trillions of US dollars).

Source: BEA.

To the extent that the current account is intended to measure the deterioration in the asset position of a country, we could use the stock of net foreign assets to infer an alternative 'inclusive of capital gains' current account. Read this way, official statistics would already indicate that the United States has run a deficit of only \$1.3 trillion, not of \$3.26 trillion in recent years, a point that has been surprisingly ignored.² But in spite of muting the size of deficits in recent years, the capital gains story cuts the puzzle, at best, in half, leaving an entire other half to be explained.

The other part of the official answer is a well-known fact: that the United States earns a higher return on its holdings of foreign assets than it pays to foreigners on its liabilities. Figure 2 shows that this differential has been fairly persistent over the years. In fact, some economists have used this difference to estimate when the US's net income figures would turn negative. Gourinchas and Rey (2006) re-evaluate the whole set of US assets and liabilities to compute a set of total yields (dividends plus capital gains) for US assets abroad and for foreign assets in the United States. They find

²But not by academics. Lane and Milesi-Ferretti (2006) notice this but attribute it to the devaluation of the dollar *vis-à-vis* the euro, which increased the dollar value of US assets in Europe. They believed that this revaluation was temporary and so no remedy to the increasing US imbalances.

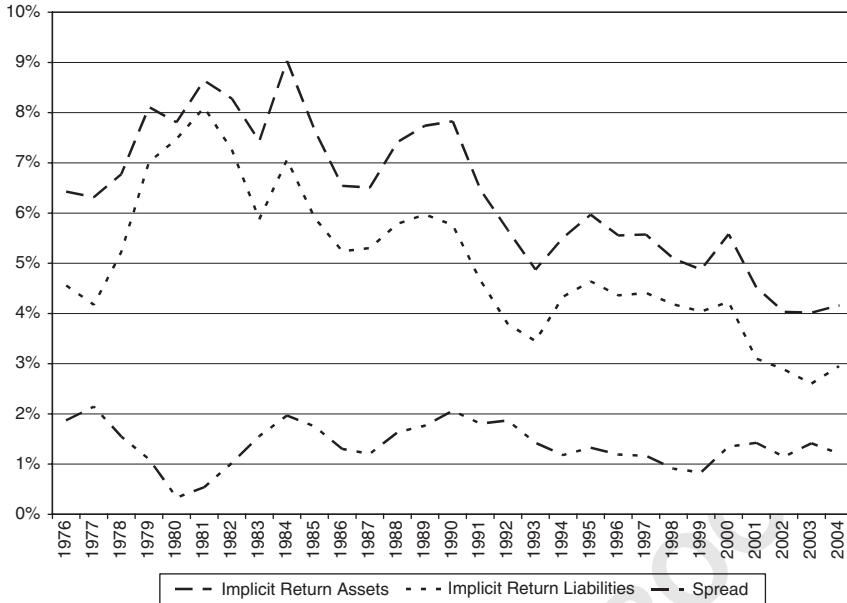


Figure 2: Return differential between assets abroad and assets at home.

Source: BEA.

sizable return differentials in favour of the United States, a situation that they refer to as a ‘privilege’. Using their estimates corresponding to the period since the demise of Bretton Woods, they conclude that the tipping point for the US economy will be reached when liabilities are 1.43 times assets, thus placing the United States still a long way from a situation in which it would become a ‘real debtor’.

But stopping there leaves many questions unanswered. Why do these return differentials exist? Is it that US investors abroad are so much smarter than foreign investors in the United States? Are global portfolio investors not free to buy any assets they want? Why would foreigners consistently pick worse assets than American investors? Can they not just ask American financial institutions to manage the money for them? Or is this an equilibrium phenomenon? But if so, what does it respond to? Is it persistent in such a way that we should assume it will persist into the future? We believe that answering these questions is a necessary first step to evaluate the sustainability of the US current account.

Our argument builds on the idea that the inconsistency can be explained by two complementary phenomena. First, that net foreign assets are not properly measured – most noticeably foreign direct investment (FDI), which is computed on the basis of a very strict set of accounting rules that

sometimes may not capture the true earning potential of the underlying assets.³ The second idea builds on the existence of a return differential. We argue, uncontroversially, that this differential is an equilibrium phenomenon due to the fact that foreigners choose to hold US assets in spite of their lower return because they perceive these assets to be endowed with other virtues (e.g. safety) that make them attractive in spite of their lower yield. More controversially, we suggest that this differential can be assimilated to an asset (which values the underlying attributes that explain why this differential exists), so that the capitalized value of this differential should be added to the measured stock of net foreign assets.

We group both the unmeasured assets, as well as the capitalized value of the unobserved attributes, into a concept called *dark matter*. In the next section, we discuss the concept of dark matter and how it changes the discussion regarding the US current account debate by showing that its accumulation has been strong enough such that it has virtually offset the accumulation of debt, thus rendering a stable net asset position for the United States. As the current account is supposed to measure the net accumulation of assets, if the assets have not changed it means that there has been a balanced current account. We then address the sustainability question: can the stock of dark matter evaporate overnight? Will it stop growing? Can the export of dark matter be trusted as an income that will continue to compensate the measured trade imbalance of the United States in the future? If so, then the growing trade imbalances are something to keep an eye on. But if the stock of dark matter is fairly robust and poised to grow, then the concern about the US external position should be much lower. We conclude with a discussion of global imbalances: if the United States is not running a current account deficit, who is not running a surplus?

II. Dark Matter

To introduce our concept of dark matter, let us start by assuming that if an asset consistently pays more than another asset, then it is worth more, even if both assets have the same historical cost or 'book value'. To value assets on the basis of their returns is just like valuing a company by calculating its earnings and multiplying by some price-earnings ratio, or valuing a property based on its rental value. For an individual company, the earnings in any given year may give an unreliable measure of its true earning potential, but if we average over an economy as large and diversified as the United States and look at trends over a couple of years, this simple

³Gros (2006a, b) agrees with us that this item is subject to gross mismeasurement, but argues that the bias goes in the opposite direction to what we suggest below.

methodology delivers reasonable results. Of course, this opens for questioning what exactly this price–earning ratio should be and why assets with different risk characteristics should be valued at the same rate. We discuss this at length elsewhere (see Hausman and Sturzenegger, 2006), but it may suffice here to say that to do so is equivalent to assuming a world with risk neutrality or complete markets. The exact rate used is relatively inconsequential to our analysis, so in what follows, we just take an arbitrary 5% rate, which implies a price–earnings ratio of 20.⁴

So let us get to work. We know that the US net income on its financial portfolio in 2005 was \$17.6 billion.⁵ This is a 5% return on an asset of \$352 billion. So we would say that in 2005, the United States was still a net creditor to the tune of \$352 billion, or about 2.8% of its GDP. As the income flow has remained fairly stable over the last twenty-five years, we would say that so have US net foreign assets. In our approach, we will just define the current account deficit as the change in net foreign assets, with no adjustments. Hence, we would say that as US net foreign assets have been stable, the country has not been running a deficit. That is, in fact, the reason why it is still a net creditor.

This approach to computing the current account, that is to derive it from the changes in net asset stocks computed by capitalizing the net investment income, can be applied to any country in the world. In Hausman and Sturzenegger (2006), we do this and show that in general both this and the official methodologies deliver similar results, although of course there are some systematic differences. It is the United States that stands out as a very large outlier! Thus, it is worth looking into this case in greater detail.

Figure 3 shows by how much the two measures differ for the United States. On the one hand, it shows BEA's international investment position in 1982 and then updates it by the cumulative current account deficits according to official statistics, which, as was already mentioned, add up to the \$5.27 trillion that the United States has overspent over the last twenty-five years. The other line shows the cumulative change in net foreign assets according to our methodology. The fact that the curve shows no meaningful trend (upward or downwards) is simply indicating that the total amount of net

⁴It has been argued (Butler, 2006) that we discount assets with different risk by the same yields. But notice that we use ex post returns, so that it is standard practice to discount these by a risk-free rate as we do here. To the extent that an ex post return differential persists, it must correspond to a risk premia that will still be paid once all contingencies are taken into account.

⁵We use the net income net of employees' compensation to focus on the return on physical and financial assets.

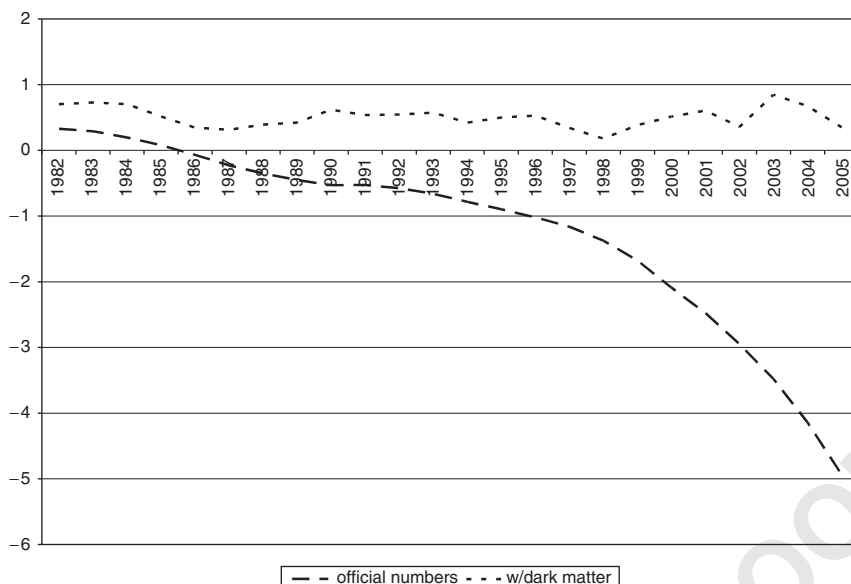


Figure 3: Cumulative Current Accounts with official statistics and with Dark Matter (in trillions of US dollars).

Source: BEA and International Financial Statistics.

foreign assets held by US residents has virtually not changed. Put differently, there have been no deficits over this period.

There is a large difference between our view of the United States as a net creditor with assets of about \$352 billion and that which results from the current account numbers. We call the difference between these two estimates *dark matter*, because it corresponds to assets, or attributes of those assets, that we know exist, as they generate revenue, but that cannot be seen (or, better said, cannot be properly measured). The name is taken from a term used in physics to account for the fact that the world is more stable than you would think if it were held together only by the gravity emanating from visible matter. In the same way that physicists infer matter in the world from its gravitational pull (but not from adding up the visible matter), we infer the assets from their returns and not from adding the current account imbalances.

Our measure does hinge on a blind trust in the net income data, at least in comparison with official stock data. But how good are either of these data? The truth is that we do not know. However, we do not feel we should be called to make a judgement on this. Our analysis simply points out to a discrepancy between the two data sources that needs to be addressed and understood. Gros (2006a), for example, agrees with us that the stock data are wrong by pointing out that the surveys systematically miss on assets that

foreigners hold in the United States, a fact that, if true, increases the inconsistency between the two series.⁶

At any rate, the growing line in Figure 4 shows the stock of dark matter. In our measure, the United States today owns about \$5.3 trillion of unaccounted net foreign assets. Because this is so large, no methodological minutiae will reconcile the facts with the statistics. We can discuss the numbers but we cannot contest the existence of dark matter.

We can also measure how much dark matter is exported or imported in any given period. For example, the official story tells us that in the five-year period between 2000 and 2005, the United States accumulated a current account deficit equal to \$3.26 trillion. We find that the net assets of the United States went down by only \$163 billion (that is only the equivalent of 5% of the current account number). Hence, the country exported some \$3.1 trillion of dark matter in this period, or about 5% of GDP annually. These results are summarized in Table 1.

III. What is Behind Dark Matter?

At least three factors account for the accumulation of dark matter. The first refers to mismeasurement of FDI. Some economies have the ability to generate ideas, as well as to transform these ideas into blueprints, new projects, new know-how, brand value, and eventually, net income. FDI is the way firms exploit these ideas by deploying them in other markets. Therefore, countries that have significant FDI abroad are providers of this know-how and expertise. To the extent that this value is not properly measured in the

⁶Gros (2006b) tries to explain the puzzle by arguing that the income flow data are wrong as well, because foreign firms in the United States seem to understate retained earnings. Some evidence is provided by the fact that once investments are categorized as direct investment reported retained earnings fall dramatically. Gros disregards transfer pricing as an explanation (so do Mataloni 2000 and Hausman and Sturzenegger 2006), but assuming foreign firms can actually dodge the taxman, it needs to be asked how these distributed earnings are used. If foreigners purchase other assets in the United States, then they would be quantified as an increase in foreign assets in the United States, very much as retained earnings by US firms abroad are computed as an increase in FDI abroad. Gros argues that retained earning in the United States should be similar to those of US firms abroad, so that they could be pulled out altogether from BOP statistics. We think there is no ground for this assumption (because as we mentioned, the earnings of foreign firms may not be 'retained' but may still be measured elsewhere). At any rate, if one is willing to make this assumption, it would imply a \$100 billion overestimation of the net income, which, in our methodology, would be equivalent to a \$2 trillion drop in net foreign assets. Because Gros (2006a) suggests that net foreign assets stocks are \$1 trillion less than actually measured, in the Gros accounting system there is still a large inconsistency between official stock data and the income flow data, except that it is in the order of \$2 trillion rather than our estimate of close to \$3 trillion.

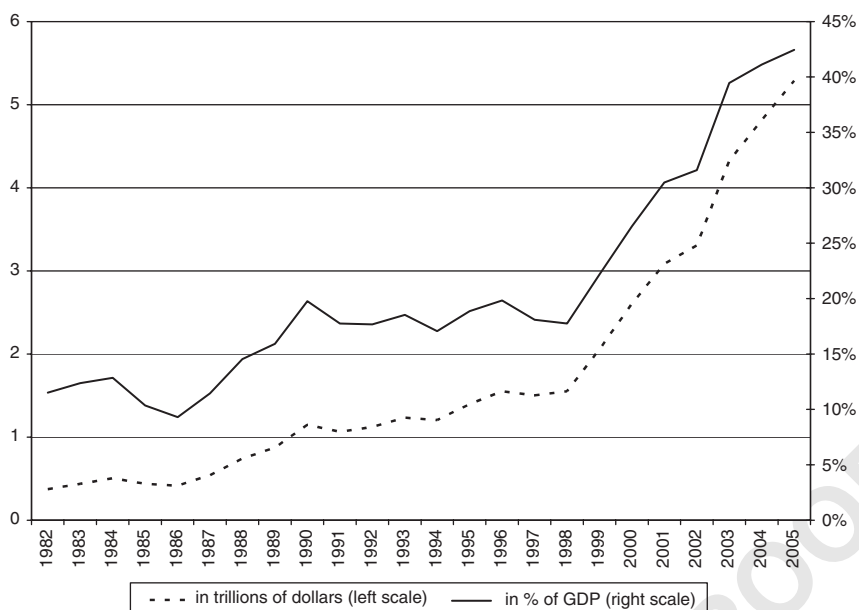


Figure 4: US Stock of Dark Matter (in trillions of US dollars and as per cent of GDP).

Source: BEA.

Table 1: Exports of dark matter in recent years

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|-----------------------------|---------|---------|---------|-----------|---------|---------|
| Export of dark matter | 548,010 | 480,959 | 221,246 | 1,017,794 | 492,146 | 470,748 |
| (in billions of US dollars) | 5.6% | 4.7% | 2.1% | 9.3% | 4.2% | 3.8% |
| as a per cent of GDP | | | | | | |

official statistics, then, the income obtained from their foreign assets may look ‘extraordinary’ for the measured level.

How could this hypothesis be tested? In Hausman and Sturzenegger (2006), we compare exports and imports of dark matter with net FDI positions taken from Lane and Milesi-Ferretti (2006). If the above hypothesis is correct, one would expect that countries that are *long* FDI should be ‘exporters’ of dark matter while *receptors* of FDI should be importers. In fact, we find this pattern to hold very strongly for a cross section of countries. Within the sample, Switzerland and the United Kingdom, in addition to the United States, appear as large exporters of dark matter, while Singapore and Ireland stand out as very large importers of dark matter.

To visualize how measured FDI may fail to capture this, let us describe current practice for valuing FDI. Current methodologies start from the book

value declared by companies and try to approximate their market value by multiplying book values by the market to book ratios in host countries.⁷ This makes sense to the extent that host markets capture the profitability, tax, expropriation risks and similar types of constraints faced by firms in those markets. However, it is also equally reasonable to think that the productive capacity of a transnational may also be somewhat captured by the source country stock market. An example may help illustrate the point. We believe that the S&P 500 may better capture the profitability of Intel-Costa Rica than the San Jose stock market. In fact, we believe that the San Jose stock market probably has no relation to the profitability of Intel's factory in Costa Rica. The company is not listed there; its profits are considered by investors in the United States when valuing Intel. If instead of using the host country stock market we use the S&P 500 market to book ratio to adjust FDI book values, US FDI would experience an increase in 'measured' value by the equivalent of \$2.74 trillion, actually sufficient to make the United States a net creditor.⁸

Our second source of dark matter is the unaccounted value of the liquidity services provided by the United States. The simplest example is that people around the world need liquid assets and choose to hold dollars in cash, which earns them a 0 interest rate. By having foreigners accumulate US currency, and paying no interest on this, the United States can accumulate current account deficits without deteriorating its net investment income account. This so-called seignorage, or the unmeasured provision of liquidity services, is a second source of dark matter. But liquidity services do not originate uniquely from seignorage. Deep financial markets may also carry a liquidity premia that allows paying lower returns for the issuers in those deep markets.

The final source of dark matter is insurance. Consider the US borrowing abroad and then using the proceeds to buy a portfolio of debt abroad. This combination of assets and liabilities earns *ex post* (even after defaults) a return differential. This return persists over time because the world is exchanging a safe asset (a US asset) for a riskier asset (a non-US asset). The difference between the two rates of returns is the insurance premium the

⁷There is a third alternative called current cost method that updates book value by relevant price indices. See Kozlow (2002).

⁸This computation is done with 2004 data, the latest available at the time of writing. Coincidentally, a new wave of research has focused on the fact that national accounts have mismeasured intangible capital by a large amount. Corrado et al. (2006) argue that US statistics exclude about \$3 trillion of intangible capital stock. It is not clear how this would affect the net investment position, or whether the miscalculation is different for the United States or other economies, but it points to the weaknesses of reported data. A similar point was made by Parente and Prescott (2000).

world is willing to pay for lowering its risk. Dark matter thus includes the selling of unaccounted insurance, which generates a premium. The United States is akin to an insurer that is willing to take a more risky asset in exchange for a more stable asset. If agents are risk averse in equilibrium, this trade can only take place if a premium is paid, on average, by the side of the market that is selling the risky asset. In a complete market set-up the present value of this difference in rates would measure the economic value of this service.

But which of these three sources is the most important? The evidence does not seem to support the liquidity story. Buiter (2006) estimates exports of dark matter in seignorage of between \$210 and \$525 billion, a small share of the total. Longstaff (2001) finds the average liquidity premia for US treasuries to run between 10 and 16 basis points. Applied to the stock of US treasuries, this delivers only miniscule exports of dark matter.

Two sets of evidence point in the opposite direction of the other channels. Higgins et al. (2005) provide supporting evidence in favour of large differential returns in FDI. They split US net foreign assets into FDI, interest rate-sensitive assets and equities, and find that the US benefits from a return differential, but only on the FDI class, and that this difference remains basically unexplained (see Kitchen 2006). In contrast, Gourinchas and Rey (2006), whom we mentioned above, compute a more comprehensive gross returns figure (that is including capital gains). When comparing foreign assets in the United States with US assets abroad, they find that there are large differences in the returns of debt, equity, bank loans and trade credit in favour of the United States, but virtually no difference in FDI. Whatever the source, it is clear that the United States is a net provider of knowledge and insurance (and to a smaller degree liquidity).

Meissner and Taylor (2006) provide an alternative computation of dark matter by estimating by how much the US return on its net foreign assets differs from a world average. They estimate that the United States has a return differential of about .5% of GDP, which, for 2005 data, would imply a stock of dark matter of about \$1.25 trillion. However, as of now, the differential is closer to 1%, yielding a dark matter estimate of about \$2.5 trillion. The authors caution about the recent increase in the exports of dark matter by arguing that the yield differentials have been declining since the mid-1960s and have been compensated by an increase in leverage. But as the world becomes more global financially, all three sources of dark matter are bound to increase. The increasing asset value of these services underlies the spectacular increase in dark matter over the last two decades and is likely to continue.

While our approach has been found to be controversial, it fits relatively well with a larger recent literature on global imbalances that has stressed

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other channels by which dark matter can be created. Dooley et al. (2004) argue that the imbalance comes from peripheral countries adopting export-led strategies with undervalued pegged exchange rates and capital controls. In this approach, dubbed Bretton Woods II, some countries are willing to purchase US assets at lower (even *expected*) returns in exchange for access to its good market; in our words, they are ‘purchasing’ the access to the US market, another form of dark matter. Caballero et al. (2005) attribute the current imbalances to a form of financial backwardness in some fast-growing countries such as China, which prevents them from writing claims on productive assets. This forces their residents to use their savings to buy foreign assets and allows foreign companies to own the Chinese productive assets, providing an alternative explanation for the return differential. In this interpretation, the US sells financial services and charges for it.⁹

IV. Can Dark Matter be Trusted?

As we have seen, over the recent years, exports of dark matter are compensating the large trade deficits in the United States. So this leads naturally to the question of whether dark matter is something that can be trusted as a way of keeping the net asset position of the United States, and the world, stable in the future. In other words, is dark matter sufficiently stable to hold the world together and avoid global financial markets from running into a crisis? This will depend, ultimately, on how steady the earning power of the assets that make up dark matter is.

Typically, the answer to this question, particularly when thinking about the 2001–05 period, was that the US enjoyed capital gains associated with exchange rate fluctuations. But these were viewed as unreliable, as exchange rates can move the other way without any notice (Lane and Milesi-Ferretti, 2006). Were the US dollar to appreciate, the United States would be left not only with a large current account deficit but also with a large capital loss in its net stock of foreign assets, compounding the reversal. However, the exchange rate channel has been discussed by Gros (2006a) and Kitchen (2006), who conclude that it is not an important part of the story. In addition, the story runs into problems when applied to the 2004–06 period, when the dollar did not further depreciate relative to the euro but dark matter kept growing.

⁹In Hausman and Sturzenegger (2006), we find that countries with large debt levels have been the largest exporters of dark matter. Their dark matter results from ‘debt relief’ operations.

There are basically three ways of assessing whether dark matter exports will continue to be present in the future. One is to analyse the underlying reasons for the existence of dark matter and to argue whether they will continue to hold. In fact, our analysis contributes to the debate by identifying the reasons why the interest differential exists, moving the debate from focusing, say, on savings (in reality, our approach would suggest that savings are mismeasured because they do not include the capital gains that have led to larger US assets or the extraordinary profitability of those assets¹⁰), but to the underlying sources for the large US net investment income. Discussion should then focus on the health of innovation and creativity of the US corporate sector, on the underlying stability of the US economy, or on the role of the dollar as a leading global store of value. For example, Barro (2005) builds a model with occasional catastrophic events with which he attempts to explain the equity premium puzzle. In a nutshell, he suggests that recurrent crises in emerging countries in the late 1990s as well as the increase in global terrorism have increased the risk premia that investors are willing to pay for riskless assets, and that because the United States remains the most solid safe haven for investments, the increased uncertainty leads to an increase in the desire to hold US assets, which explains why the yields on US treasuries fell in spite of a growing fiscal deficits during the 2002–04 cycle. This, in turn, would appear as an increase in dark matter exports. Similarly, Kugler and Weder (2004, 2005) analysed the return benefit enjoyed by Switzerland. They find that the return consolidated with Switzerland's neutrality in WWI, and has remained very strong since. In short, to the extent that these fundamentals remain stable so will the interest differential. As global markets explode in size, the differential will act on a larger base, thus leading to increases in dark matter exports.

An alternative is to look at historical evidence. Did other countries enjoy similar differentials in the past? Were these stable? Meissner and Taylor (2006) tackle this question. They analyse the United Kingdom at the end of the 19th century, as well as the United States in the postwar period. They argue that the evidence points to the fact that yield differentials declined over time, which they use as a cautionary note on the possibility of the United States sustaining large differentials in the future. But they also find that these differentials were fairly stable as a share of GDP, mostly due to an increase in leverage. In the case of the United Kingdom, the process

¹⁰According to the official statistics, the United States appears as a profligate consumer with dismal savings. However, these numbers understate the US savings rate by the amount of dark matter it exports and overstates the savings of the rest of the world by the amount of dark matter it imports.

continued until an abrupt collapse at the outbreak of WWI, leaving open the question of what would have happened if such an event had not occurred.

Finally, a third alternative is to look at the time series properties of dark matter exports over recent years as we did in Figure 4. The stock now stands at over 40% of GDP. Since 1982, it has fallen in only five years. The largest drop, which took place in 1985, was barely 1.6% of GDP. In short, it would take an unprecedented deterioration of the value of dark matter to even approximate the net asset position that worries analysts today.¹¹

In fact, an alternative view could even say that the increasing official current account deficit of the United States is the consequence of the rising export of dark matter, which has gone from 1.5% of GDP before 2000 to 5% of GDP since 2000. It is this source of wealth that funds the booming import bill of the United States. To the extent that its underlying causes are stable, less should be the worry with the measured imbalances.

V. A New Look at Global Imbalances

With a better understanding of what dark matter is, we take our exercise to the whole world. Figure 5 presents the official evolution of the net asset position of different major global players as a share of world GDP as presented in the IFS international investment position data. It shows a world that is increasingly unbalanced, with Japan and the rest of the world financing Europe and, in larger quantities the United States, which appears to be accumulating a growing external debt. (In these graphs, the rest of the world is calculated as a residual to make things add up to zero). The imbalances appear to be relatively small, but the net asset positions seem to trend for most of them.

Notice how this compares with Figure 6, which we construct by capitalizing the net income that each country makes on its asset position. As can readily be inferred, the world looks quite different once dark matter is taken into account. First and foremost, the United States does not appear as a net debtor but as a net creditor and, as mentioned above, its net foreign asset position has remained stable over the last twenty years. Japan, consistent with official data, is a growing creditor, while the European Union and the rest of world are net debtors. Perhaps, the most striking feature of Figure 6 is that while net asset positions seem to be larger than when measured with official numbers, it shows a world that is surprisingly balanced with relatively little trend for most groups.

¹¹Econometrically, one can show that the trend is positive standing at about 2.4% of GDP for the period 1982–2005, and strongly statistically significant (p of .00019).

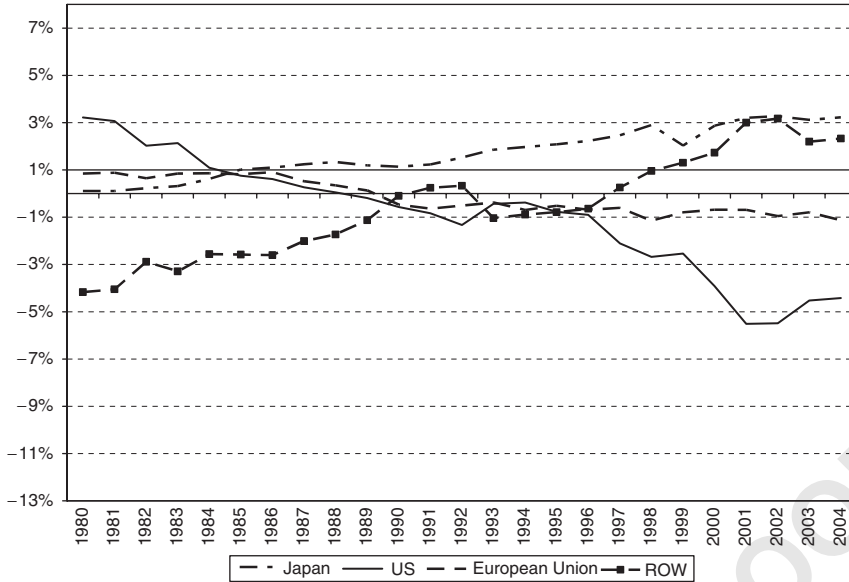


Figure 5: Net Foreign Assets in the World according to Official Figures (as per cent of world GDP).

Source: International Financial Statistics.

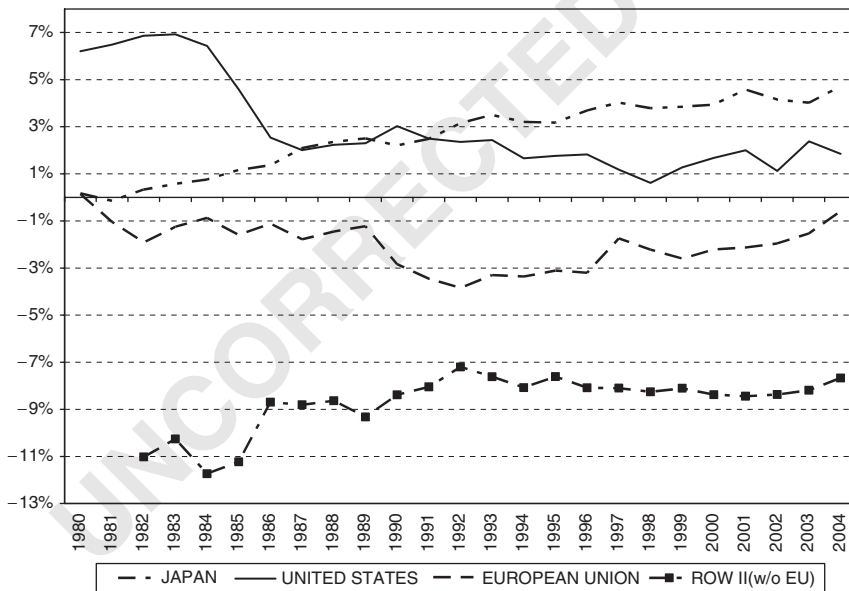


Figure 6: Net Foreign Assets taking into account Dark Matter (as per cent of world GDP).

Source: Authors' computations on International Financial Statistics data.

VI. Conclusions

In a nutshell, our story is very simple. The income generated by a country's financial position is a good measure of the true value of its assets. Once assets are valued accordingly, the United States appears to be a net creditor, not a net debtor, and its net foreign asset position appears to have been fairly stable over the last twenty years. The bulk of the difference with the official story comes from the unaccounted export of know-how carried out by US corporations through their investments abroad and from the fact that investors are willing to trade risky positions for safer assets in the United States. This explains both why the United States appears to be a consistently smarter investor, making more money on its assets than it pays on its liabilities, and why the rest of the world cannot wise up. In addition, the value of this dark matter seems to be rather stable, indicating that these channels are likely to continue to compensate for the measured trade deficit in the near future.

This does not mean that the United States may not be exposed or eventually subject to a liquidity crunch or a sudden stop. There may be large changes in the political balance in the world, or other countries may match the United States in terms of security and stability, weakening the ability of the United States to extract a return differential. Our point is that globalization has made the flows of dark matter a very significant part of the story and that the traditional measures of current account balances paint a much distorted picture of reality. In particular, they point towards imbalances that are not really there, making analysts predict crises that, for good reason, remain elusive.

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