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THE U.S. AS A DEBTOR

By Allan H. Meltzer

Many critics of current economic policy and performance fret that we have become a debtor nation. They point with alarm to the growing, some would say mounting, debt we owe to foreigners. More than a little xenophobia enters when talk turns to Japanese purchases of our farms, factories, and office buildings.

In the recent political campaign, now mercifully concluded, Governor Dukakis and Senator Bentsen raised this issue many times. Were they arousing fears unnecessarily? Or, were they warning the public about a serious problem?

First, the numbers. The official statistics though widely repeated are misleading. Net international investment, as reported by the U.S. Commerce Department, includes a variety of assets and liabilities such as the government's gold stock, private investment in farms and factories abroad, and investments here by foreigners. It also includes foreigners' bank deposits, their ownership of corporate stocks and bonds issued by government and corporations, and our citizens' ownership of similar foreign assets. Our reported net international debt is the difference between the sum of these assets and liabilities. At the end of 1987, we reported net debt of $368.2 billion.

This number is almost certainly too high. The government values our gold stock at $42.22 an ounce, one-tenth of its current market price. Even more erroneous is the valuation of investment. If you hold shares of Tokugawa Motors that grandpa bought at the turn of the century, they may be worth vastly more today. The Commerce Department carries all assets at acquisition cost, however, and it makes no effort to mark asset values to market. The same is true of liabilities. The Latin American debt owned by U.S. banks is carried at face value, though its market value is lower.

On balance, we acquired net assets abroad in the 1950s and 1960s, and foreigners have acquired net assets here in the 1980s. Our investments in
Europe, Asia and Latin America have had more time to rise in value than foreign investments here, so the underestimation in official statistics is greater for the foreign assets we own than for our debts. The published numbers make us appear to be a much larger debtor than we are. Some recent efforts to correct the numbers suggest that we may not be a net debtor after all, at least not yet.

An alternative way of estimating the net value of our productive assets is to compare the earnings we get from past investments abroad to the payments we make on foreigners' investments here. Through the end of 1987, the receipts exceeded the payments, suggesting that our debts are smaller than our assets. This suggests, again, that we are not now a net debtor.

Of course, we continue to borrow more than we lend, so if we are not a debtor now, we will be. But, the size of the net debt is important. We will have to service the debt in future years by producing more than we spend. That is a fact. Those who view the debt problem with alarm use this fact to caution that our standard of living must fall.

I was tempted by this view a few years ago, but I am convinced that I overstated the problem then and that those who raise these concerns overstate the problem now. Properly measured, paying for the net debt is unlikely to require more than one percent of GNP at its peak, sometime in the next decade. As GNP grows and standards of living rise, the cost of servicing the debt becomes less important.

Historically the principal foreign investors in factories and firms have been British and Dutch investors. Prior to World War I, these investors owned a significant share of the U.S. capital stock. They sold these assets to finance two wars, but they have now returned as investors. Once again, Britain and Holland are the two countries with largest investments in U.S. real assets like buildings, factories, and stores. Japanese investors concentrate much more on government bonds.

Some see the debt as a sign of weakness. This is a mistake. Our economic strength as a nation and our standard of living as a people depend mainly on the use we make of resources, not on how we finance our purchases. If we borrow from abroad to finance increased productive investment, we add to our productive potential and increase our ability to pay the interest on our debt in the future. If we spend for current consumption, we add to consumer satisfaction and to debt, but we do not increase our ability to service the
Those who are concerned about our foreign debt should favor policies that increase investment. Replacing taxes on capital, like the corporate income tax, with taxes on consumption would help to spur productive investment and reduce the growth of consumption. Servicing the debt would be easier, and both we and our children would be richer in the future.

One fear, often raised, is that foreigners can threaten us by withdrawing their invested balances. This neglects that ownership of the debt and capital is mainly in private hands; there are many owners, and they rarely have a common interest. If we do not fix the exchange rate, any effort to divest ownership of dollar assets is bound to affect values, to impose costs on the creditors, and to offer bargains to other investors. Many of the arguments about herd-like actions by foreign investors are unthinkingly based on experience with fixed exchange rates and a gold standard, particularly Britain's experience in the 1920s. Under the current fluctuating exchange rate system, the process works differently. Investors observe losses in value as others sell, and they reconsider their own best course. This limits a "run" on the dollar.

This does not mean that we should be sanguine or unconcerned about our position. But, it does mean that we should be skeptical about those who predict a crisis. If we pursue sound economic policies and avoid fixed exchange rates, protectionist policies, tax increases, mandated benefits and more regulation, we are capable of paying for our current and prospective debt while increasing our standard of living.