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Truth In Trade

How current is the U.S. Current Account?

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It seems like every month when the government issues new data we worry that the current account deficit expands yet again and doesn't seem likely to head back into balance any time soon. Analysts predict that the deficit, which reached $393.4 billion in 2001—and so far in 2002 it looks even worse—will have a serious negative impact on the value of the dollar, which ultimately will raise interest rates and slow the U.S. and world economic recoveries.

One of the foremost American experts on balance of payments, Dr. Catherine Mann, put it this way: "The U.S. merchandise trade deficit will hit an annual rate of $350 billion by the end of [1999]. [Note: It hit $427 billion in 2001, according to the Bureau of Economic Analysis.] The current account deficit will reach an historic high of almost 4 percent of GDP. When these deficits hit similar levels in the middle 1980s, the dollar fell by 50 percent and protectionist trade pressures surged."[1] Everyone seems to agree we have something to be worried about.

The view from Europe is no more optimistic. According to Dean Spinanger, Senior Research Fellow at the Kiel Institute for World Economics in Germany, "The large U.S. current account deficit has become a worry for some Europeans. While not an issue as long as the United States was a magnet for capital from around the world, the slowdown in economic activity and in particular the aftermath of the company boardroom scandals seems to be diverting capital elsewhere. Europeans are anxiously viewing the size of the current account gap with some concern."

But before we close the borders to imports, we need to be sure that the data are in fact telling us that something is terribly wrong. Traditionally, the hysteria over the current account deficit (the difference between goods and services exports and imports plus net income from portfolio investment, less certain other direct payments) is derived from worries about the imbalance in our trade in goods and services. But increasingly U.S. companies sell through affiliates rather than traditionally-measured cross-border exports. Sales by affiliates abroad are rarely published.

The operations of foreign affiliates of U.S. firms (at least 10 percent U.S. ownership) produce huge results. Sales through some 23,000 majority- and minority-owned U.S. affiliates of foreign corporations in 1999 (the most recent year for which we have reliable statistics) totaled $2.6 trillion, a very big number by any measure, more than double the value of 1999 export sales of $957 billion—the common measure of U.S. global sales. These sales strengthen the U.S. parent company as profits from the sales may be used to fund U.S.-based R&D, to the benefit of U.S. jobs as well as abroad.

But our current approach to measuring the current account and the impact on the United States of such international activity does not show the benefits to the United States of sales of foreign affiliates. Exports of goods and services are well-reported in the current account; the net benefit to U.S. companies of foreign affiliate sales is not. This is because the present international accounts treat affiliates as residents in their countries of operation

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(a "residency-based" view of international operations), rather than in the countries of their owners (an "ownership-based" view of international operations).

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An "ownership-based" approach to measuring the balance of payments would permit policy makers, investors and others to better understand the real scope of U.S. business activity abroad and its benefits to the U.S. economy. This approach to measuring the impact of the international economy on the United States has been endorsed by a growing number of economic experts, both in the public as well as private sectors, since the early 1990s. For example, in 1992 the National Research Council advocated combining exports with sales by affiliates in the same line item of the current account report. Others have suggested a parallel, or side-by-side, depiction of the two types of data. All agree that it is desirable to establish the concept of "global commercial activity" for U.S. multinational corporations. For now, the best we have is an occasional report from the Bureau of Economic Analysis of the current account on an ownership basis.

Marina v. N. Whitman, a member of the Bureau of Economic Analysis Advisor Committee and a professor of public policy and business at the University of Michigan, addressed the issues of residence versus ownership in the following context: "The question of whether the residency or the ownership concept is more relevant to the distinction between 'domestic' and 'foreign' goods and services has been on the radar screen at least since the early 1990s.… The question is relevant for a variety of national policy issues—including, for example, the question of which firms should be eligible for membership in government-private partnerships.…" Ms. Whitman concludes as follows: "In fact, the answer differs with the question at issue. Where returns to labor in the form of jobs and wages are concerned, it is the residency concept that matters; for returns on capital, the ownership concept is generally more appropriate. The ownership concept also dominates with respect to U.S. economic influence on the world economy, the global competitiveness of American firms, and issues regarding market access for these firms. . .[T]hus, the answer to the question, 'which one should we track and measure?' in this case is 'both.'"[2]

An ownership-based approach to calculating the current account is really quite straightforward. It shows U.S. receipts from affiliates abroad, less local costs incurred abroad (e.g., labor, rent) and purchased inputs used to generate those receipts. A parallel calculation is made for the net receipts of foreign affiliates operating in the United States.

An ownership-based view of the current account allows a better understanding of the impact of the growing integration of the world economy on the United States. To this end, the government should publish the ownership-based data as prominently as the goods and services data: in other words, every month, along with the traditional "residency-based" data. Equal reporting of ownership-based data would have several attractive features. First, the current deficit on goods, services, and net receipts trade declines significantly when the benefits of sales of foreign affiliates are factored in. In 1999, the deficit was $67.0 billion less than the deficit on trade of goods and services in the conventional calculation.

Second, the data can be sufficiently disaggregated to see that consistently more than 80 percent of sales of U.S. affiliates abroad represents U.S. content, demonstrating strong positive linkages between this investment and employment and sales in the United States.

Changing statistics with credibility is not easy, and often takes years. Better to start now. Commenting on the exclusive obsession with trade rather than sales of affiliates, Joseph Quinlan, Senior Global Economist at Morgan Stanley, and Marc Chandler, Chief Currency Strategist at Mellon Financial Corporation, wrote in a recent article in *Foreign Affairs*: "Whatever the proper explanation, a simple and important fact is absent from the debate: the trade balance is no longer a valid scorecard for America's global sales and competitiveness. Given a choice, U.S. firms prefer to sell goods and services abroad through their foreign affiliates instead of exporting them from the United States. How U.S. firms compete in world markets, in other words, goes well beyond trade." It is time our statistics kept pace. ◆

1 Catherine Mann, *Is the U.S. Trade Deficit Sustainable?* (Washington, DC: Institute for International Economics, 1999).

2 Marina v. N. Whitman, *Survey of Current Business* (May 2002).