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America, the Balanced

CAMBRIDGE – When the United States' current account fell into deficit in 1982, the US Council of Economic Advisers accurately predicted record deficits for years to come, owing to budget deficits, a low national saving rate, and an overvalued dollar. If the US did not adjust, knowledgeable forecasters intoned, it would go from being the world's largest creditor to its largest debtor. Many of us worried that the imbalances were unsustainable, and might end in a "hard landing" for the dollar if and when global investors tired of holding it.

The indebtedness forecasts were correct. Indeed, every year for more than three decades, the US Bureau of Economic Analysis (BEA) has reported a current-account deficit. And yet now we must ask whether the US current-account deficit is still a problem.

For starters, the world's investors declared loud and clear in 2008 that they were not concerned about the sustainability of US deficits. When the global financial crisis erupted, they flooded *into* dollar assets, even though the crisis originated in the United States.

Moreover, a substantial amount of US adjustment has taken place since 1982 – for example, the dollar depreciations of 1985-1987 and 2002-2007 and the fiscal retrenchments of 1992-2000 and 2009-2014. The big increase in domestic output of shale oil and gas has also helped the trade balance recently.

As a result, the US current-account deficit in 2013 had narrowed by half in dollar terms from its 2006 peak, and from 5.8% of GDP to 2.4%. This is a decline of two-thirds when expressed as a share of global output.

A symmetric adjustment has also occurred in China, via real appreciation of its currency and higher prices for labor and land. China's current-account surplus peaked in 2008 at more than 10% of GDP and has since narrowed dramatically, to 1.9% last year. China's trade adjustment in some respects followed that of Japan, the original focus of American trade anxieties in the 1980s.

I propose a third, more speculative reason why it may be time to stop worrying about the US current-account deficit. It is possible that, properly measured, the true deficits were smaller than has been reported, and even that, in some years, they were not there at all.

Every year, US residents take some of what they earn in overseas investment income – interest on bonds, dividends on equities, and repatriated profits on direct investment – and reinvest it then and there. For example, corporations plow overseas profits back into their operations, often to avoid paying the high US corporate income tax implied by repatriating those earnings. Technically, this should be recorded as a bigger surplus on the investment-income account, matched by greater acquisition of assets overseas. Often it is counted correctly. But there is reason to think that this is not always the case.

The world has long run a substantial deficit in investment income, even though the correct numbers should sum to zero. The missing income must be going somewhere.

Even for officials as highly competent as those at the BEA, it is impossible to keep track of all of the stocks and flows in the international economy. Everyone knows that errors and omissions are large, especially when it comes to financial transactions. Underfunding of statistical agencies exacerbates measurement problems, but it does not create them.

Less well known, however, is a particular pattern in the revisions of the US international investment position. The currently available historical statistics show that in every year from 1982 to 2000, the initial estimate of the net international investment position was subsequently revised upward, as statisticians found overseas assets about which they previously had no way of knowing. Since then, some subsequent revisions have been positive and some negative. But, despite more frequent surveys of portfolio holdings in recent years, certain new asset acquisitions – for example, some held with foreign custodians – still most likely go unreported.

The numbers are potentially large. The reported US current-account deficits from 1982 to 2013, based on subsequent revisions, total $9.5 trillion. And yet the deterioration in the US international investment position over this period was not much more than half of that amount ($5.7 trillion if measured relative to the revised estimate for 1981).

Certainly a lot of the discrepancy is attributable to valuation effects: since 1982, the dollar value of overseas assets has increased repeatedly, owing to increases in the dollar value of foreign currency and increases in the assets' foreign-currency value. But part of the discrepancy also reflects the discovery of missing assets, some of which may have originated in the reinvestment of overseas income.

The missing credits also originally could have been earned in other ways. For example, US multinational corporations sometimes over-invoice import bills or under-report export earnings to reduce their tax obligations. Again, this would work to overstate the recorded current-account deficit.

Consider an (admittedly extreme) illustration. If true investment income were double what is reported, the difference was reinvested abroad in the years 1982-2000, and those assets were discovered by 2014, that would explain about half of the upward revision in the US net international investment position.

If something like this under-reporting of reinvested earnings or other balance-of-payments credits has gone on in the past, it may still be going on today – especially with US firms becoming aggressive about arbitraging corporate income tax. And if true investment income is indeed as large as double what is reported, the true US current-account balance entered the black in 2009 and has been in surplus ever since.

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