

Sharecroppers or Shrewd Capitalists?

Projections of The U.S. Current Account, International Income Flows, and Net International Debt

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*Opinions or views expressed in this presentation are those of the author
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Why is this important?

- Questions of “sustainability” of U.S. net international investment (debt) position
- Implications for U.S. economic outlook – interest rates, exchange rates, net exports, “financial instability?”
- Role of net international income flows in determining U.S. national income
- Political pressures re trade policies

Primary focus of paper

For:

1. Given alternative projections of the trade deficit / net exports;
2. Varying assumptions about domestic and international rates of return by asset type;
3. Alternative valuation adjustments;

What are the alternative outlooks for the U.S. net international debt position, CA and income flows?

Net international income flows -- part of the “wedge” between GDP and National Income:

Table 9.—Relation of Gross Domestic Product, Gross National Product, and National Income

[Billions of dollars]

	2003	2004	2005	Seasonally adjusted at annual rates				
				2005			2006	
				II	III	IV	I ^r	II ^r
Gross domestic product	10,960.8	11,712.5	12,455.8	12,346.1	12,573.5	12,730.5	13,008.4	13,209.7
Plus: Income receipts from the rest of the world	336.8	410.2	513.3	489.0	527.2	564.9	603.3	654.0
Less: Income payments to the rest of the world	280.0	363.9	481.5	460.6	475.0	552.4	574.3	634.8
Equals: Gross national product	11,017.6	11,758.7	12,487.7	12,374.6	12,625.7	12,743.0	13,037.4	13,228.9
Less: Consumption of fixed capital	1,336.5	1,436.2	1,604.8	1,491.1	1,898.0	1,562.5	1,548.0	1,566.6
Less: Statistical discrepancy	48.8	66.7	71.0	88.1	84.5	74.3	-61.9	-76.5
Equals: National income	9,632.3	10,255.9	10,811.8	10,795.4	10,643.2	11,106.2	11,551.3	11,738.8
Compensation of employees	6,325.4	6,650.3	7,030.3	6,953.7	7,093.6	7,184.4	7,400.3	7,532.4
Wage and salary accruals	5,127.7	5,377.1	5,664.8	5,601.3	5,715.2	5,787.0	5,970.1	6,080.4
Supplements to wages and salaries	1,197.7	1,273.2	1,365.5	1,352.4	1,378.4	1,397.4	1,430.3	1,451.9
Proprietors' income with inventory valuation and capital consumption adjustments	811.3	911.1	970.7	965.8	967.3	996.8	1,008.3	1,014.5
Rental income of persons with capital consumption adjustment	133.0	127.0	72.8	102.8	-11.5	81.5	76.8	67.0
Corporate profits with inventory valuation and capital consumption adjustments	993.1	1,182.6	1,330.7	1,342.9	1,266.3	1,393.5	1,569.1	1,618.6
Net interest and miscellaneous payments	524.7	485.1	483.4	477.1	482.9	490.0	514.8	510.0
Taxes on production and imports less subsidies	759.3	819.4	865.1	864.7	872.1	874.2	897.4	911.2
Business current transfer payments	83.8	85.5	74.2	99.9	.2	99.1	93.8	94.5
Current surplus of government enterprises	1.7	-5.0	-15.4	-11.3	-27.7	-13.3	-9.2	-9.5
Addendum:								
Gross domestic income	10,912.0	11,645.8	12,384.8	12,258.1	12,489.0	12,656.2	13,070.3	13,286.2

^r Revised. Revisions include changes to series affected by the introduction of revised wage and salary estimates for the first quarter of 2006.

Americans ... would chafe at the idea of perpetually paying tribute to their creditors and owners abroad. A country that is now aspiring to an “Ownership Society” will not find happiness in – and I’ll use hyperbole here for emphasis – a “Sharecropper’s Society.”

-- Warren Buffett, March 2005

Bottom line: It's likely not as bad as the “conventional wisdom” suggests ...

... because of a variety of beneficial relationships including:

- Outlook for *improving trade deficit* (Blue Chip);
- Persisting positive *valuation effects* that offset a significant part of the negative financial flows from current account deficits;
- Persisting *differences in rates of return* on U.S.-owned assets abroad vs. those on foreign-owned assets in the United States.

International investment position, financial flows,
current account, net income flows:

$$(1) \quad I_t^{NET} = I_{t-1}^{NET} + f_t^{NET} + p_t^{NET} + e_t^{NET} + o_t^{NET}$$

$$(2) \quad f_t^{NET} = ca_t + k_t + stat_t$$

$$(3) \quad ca_t = (x_t - m_t) + t_t + (y_t^{US} - y_t^{FOR})$$

See full paper at <http://users.starpower.net/jkitch/ShareShrewd.pdf> for more information.

Effective rates of return and income flows for U.S.-owned assets abroad

$$(8) \quad \rho_t^{US,D} = \frac{y_t^{US,D}}{D_{t-1}^{US}}$$

$$(6) \quad y_t^{US} = y_t^{US,D} + y_t^{US,B} + y_t^{US,S} + y_t^{US,N+A} + y_t^{US,O+G} + y_t^{US,w}$$

$$(9) \quad y_t^{US} = \rho_t^{US,D} D_{t-1}^{US} + \rho_t^{US,P} (B_{t-1}^{US} + S_{t-1}^{US} + N_{t-1}^{US} + A_{t-1}^{US}) + \rho_t^{US,O+G} (O_{t-1}^{US} + G_{t-1}^{US}) + y_t^{US,w}$$

Analogous equations for foreign-owned assets in U.S. ...

For illustration, consider alternative cases (subset of those in paper):

Base: Exchange rate depreciation about 15% over 10 years
Blue Chip net export path (-5.6% of GDP to -2.4% of GDP)
Continued differential in ROR for DFI assets
Persistence of “other” valuation effects difs. but declining effect

ALT 1: No exchange rate depreciation
(HKT) Net export deficit persists at about 5% of GDP
Continued differential in ROR for DFI assets
No “other” valuation effects (and no exchange rate val. Effects)

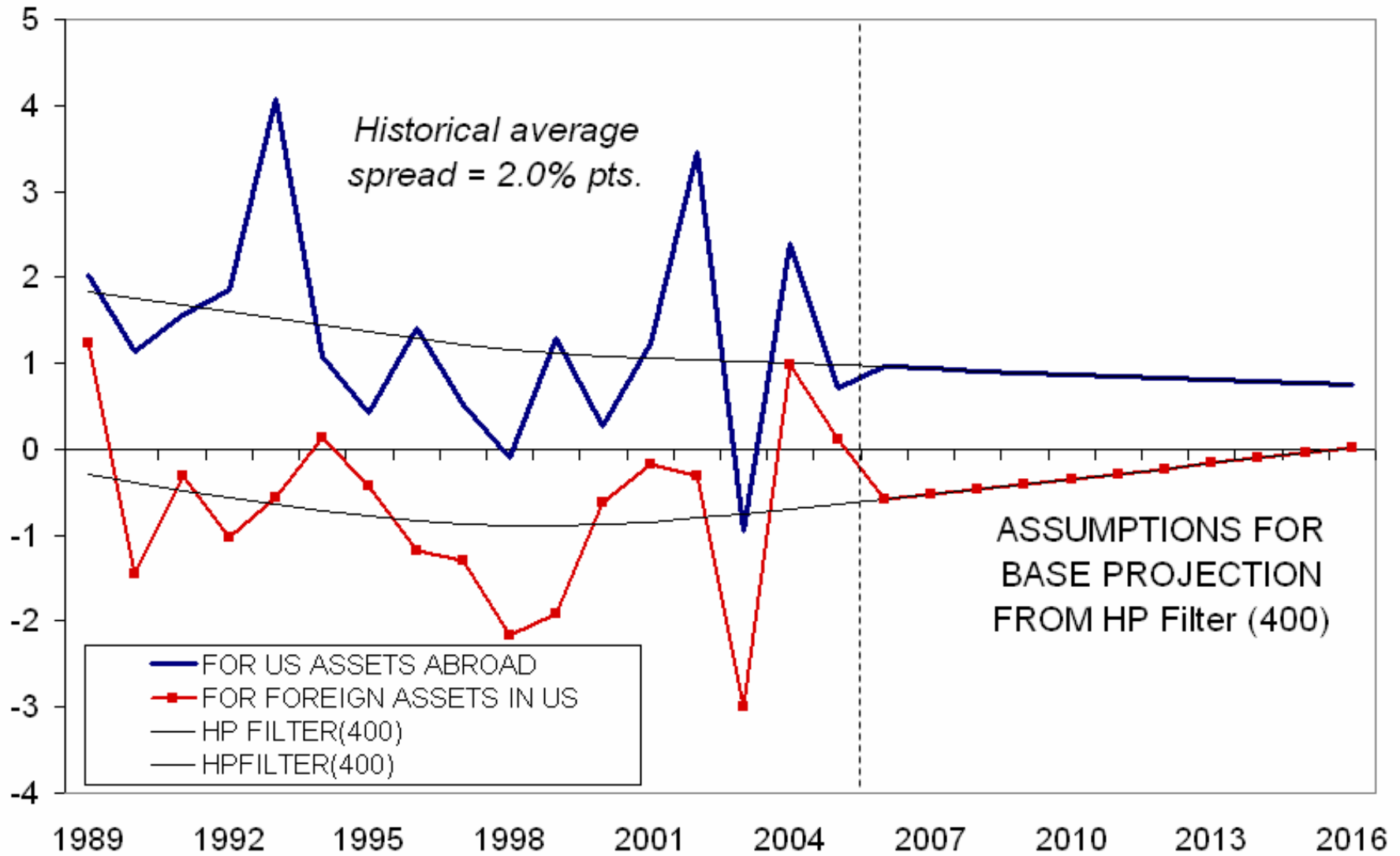
ALT 2: No exchange rate depreciation
(R&S) Net export deficit widens to 8% of GDP
Differential in ROR for DFI assets eliminated (and US i rates up)
No “other” valuation effects (and no exchange rate val. Effects)

Alternative Cases for Illustration

CASE	NET EXPORTS	EXCHANGE RATE	ROR DFI	VALUATION EFFECTS
BASE	-5.6% of GDP to -2.4% (Blue Chip)	-15% over 10 years	Continued difference 10% v. 5%	YES (All)
ALT 1 (HKT)	Persists at -5% of GDP	No change	Continued difference	No Other, Exch.
ALT 2 (R&S)	Deficit widens to -8% of GDP	No change	Difference eliminated	No Other, Exch.

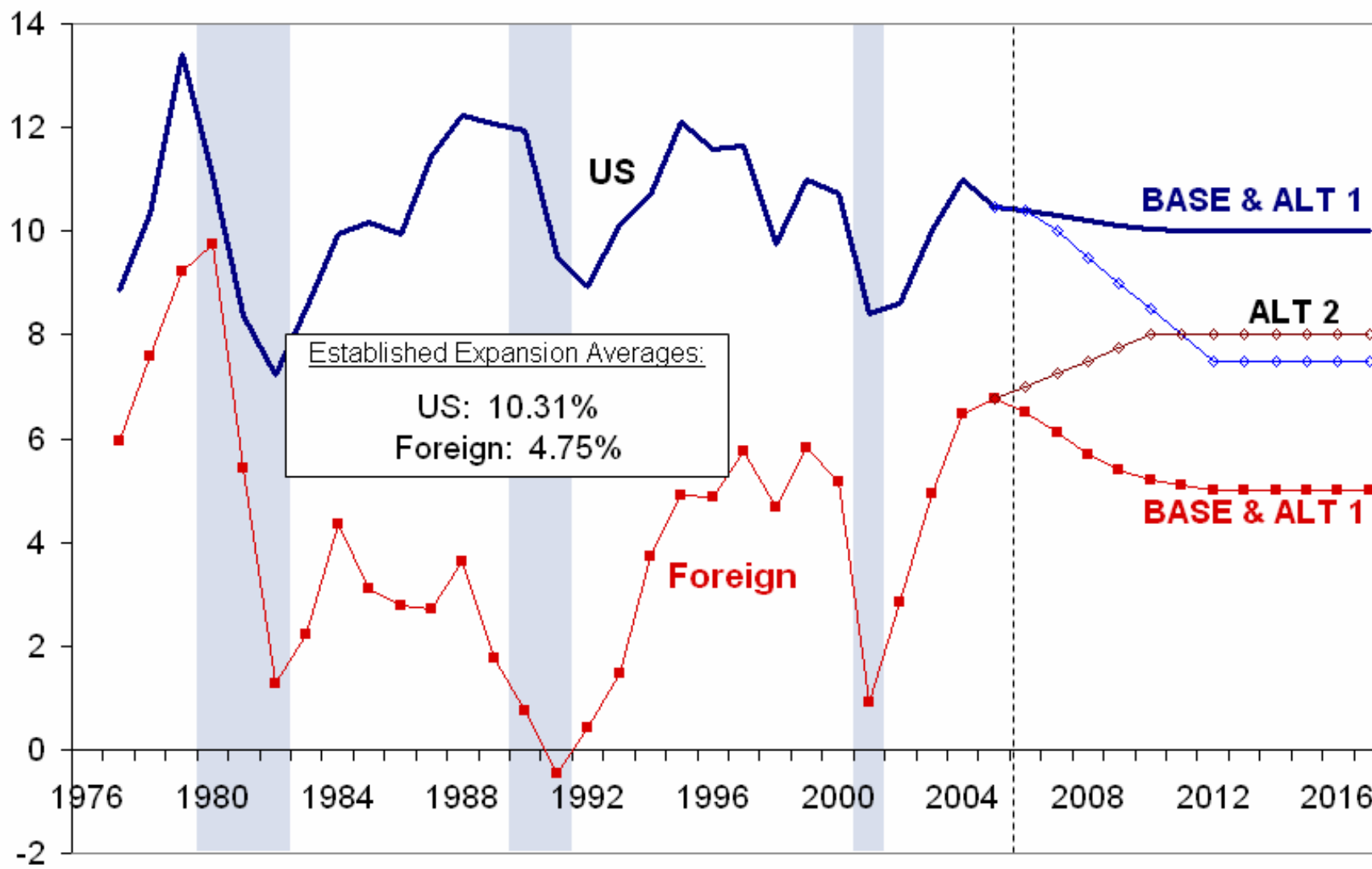
"Other Changes" Effects as Percent of Value

PERCENT



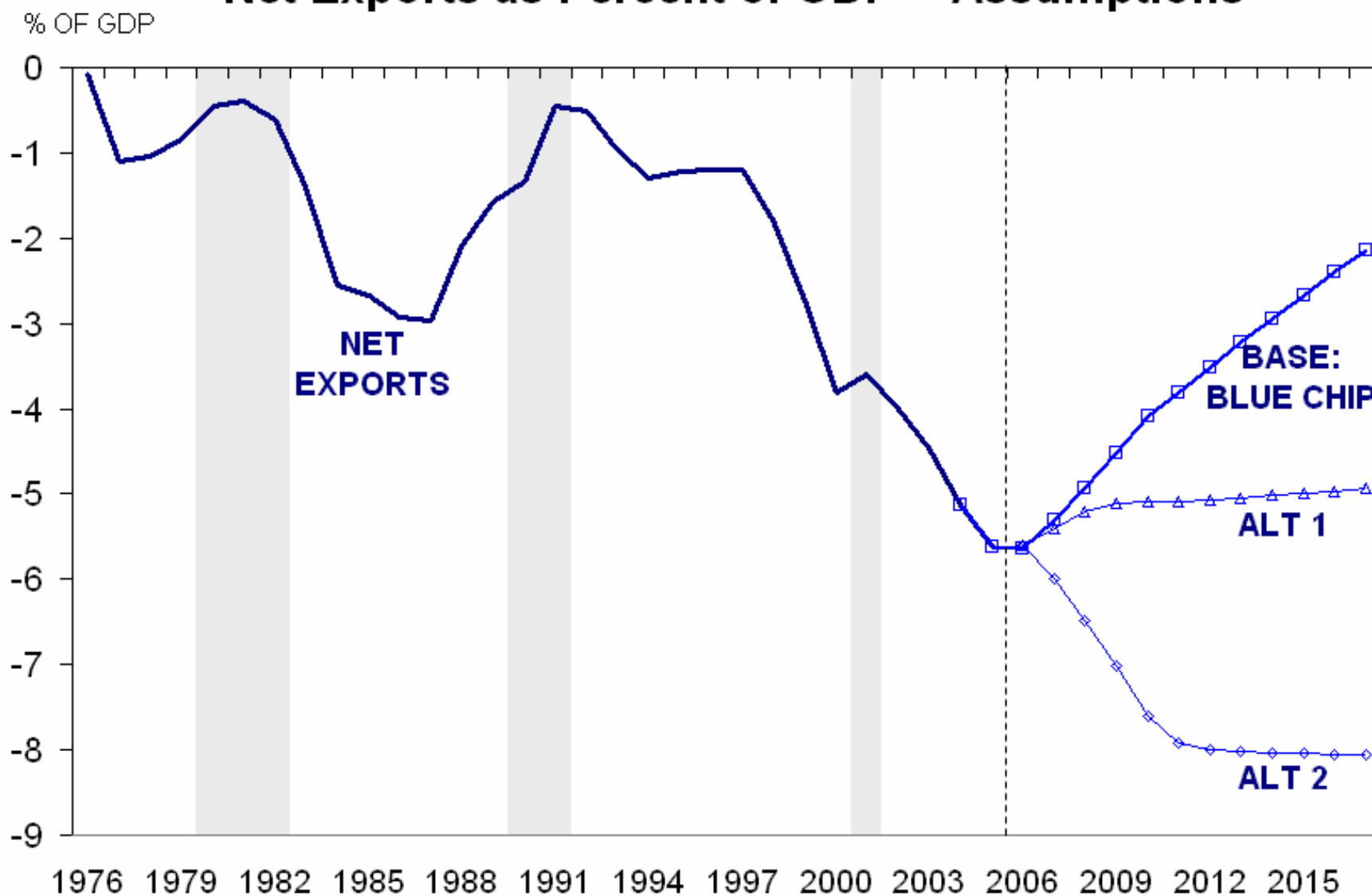
Effective Rates of Return on Direct Investment

PERCENT



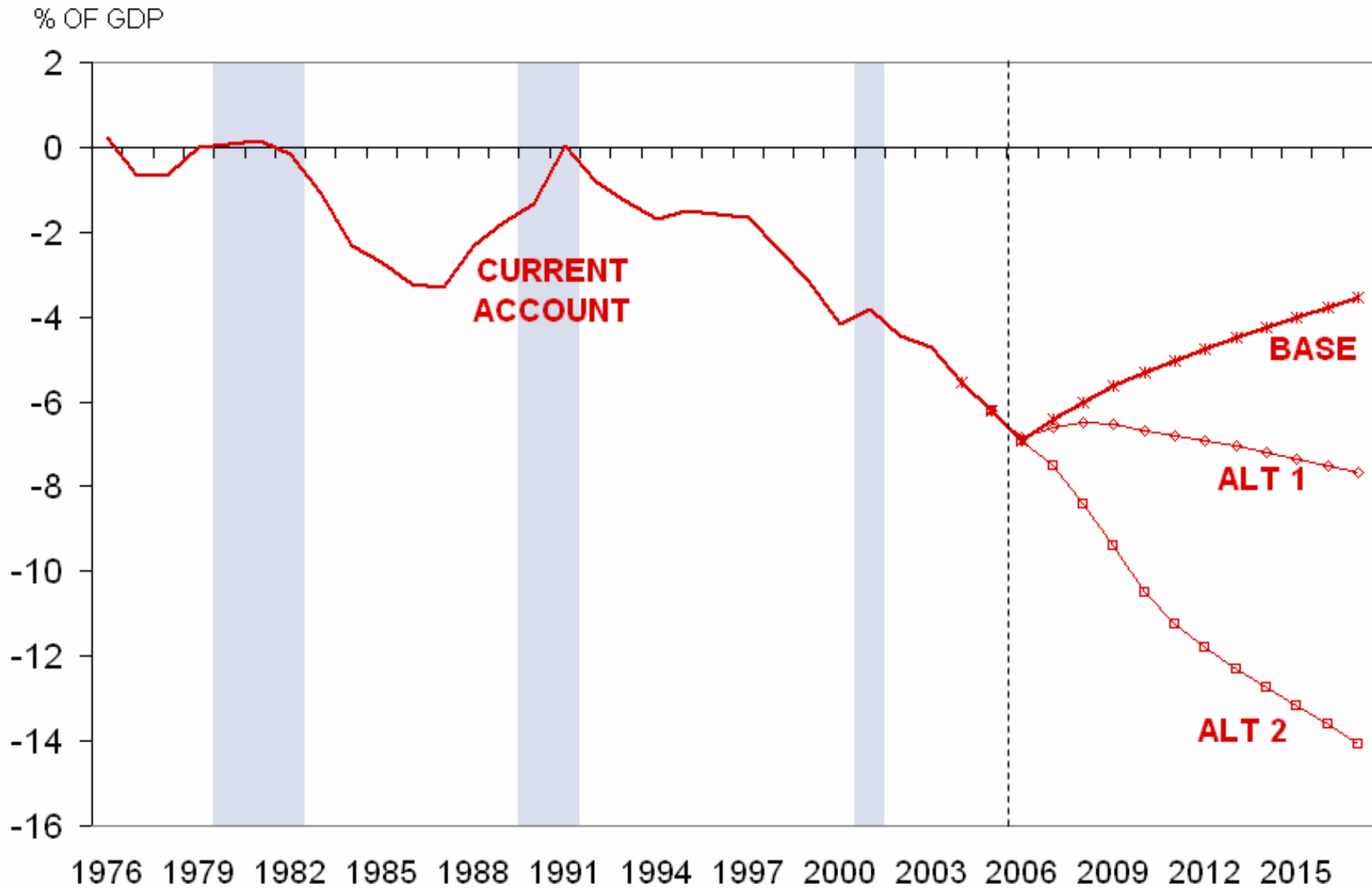
Shaded areas are U.S. recession years.

Net Exports as Percent of GDP -- Assumptions



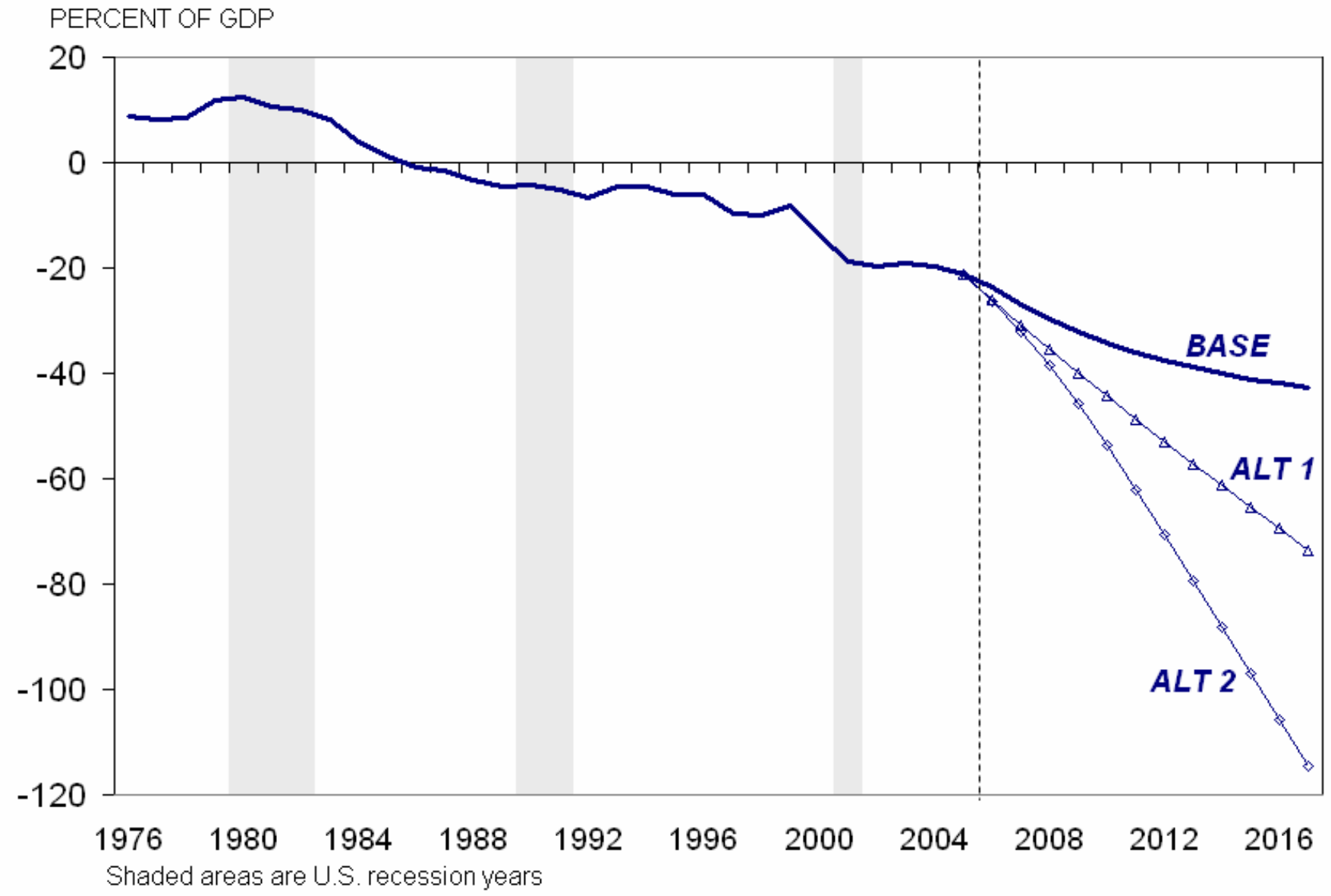
Shaded areas are U.S. recession years.

Derived Current Account from Assumptions and Model

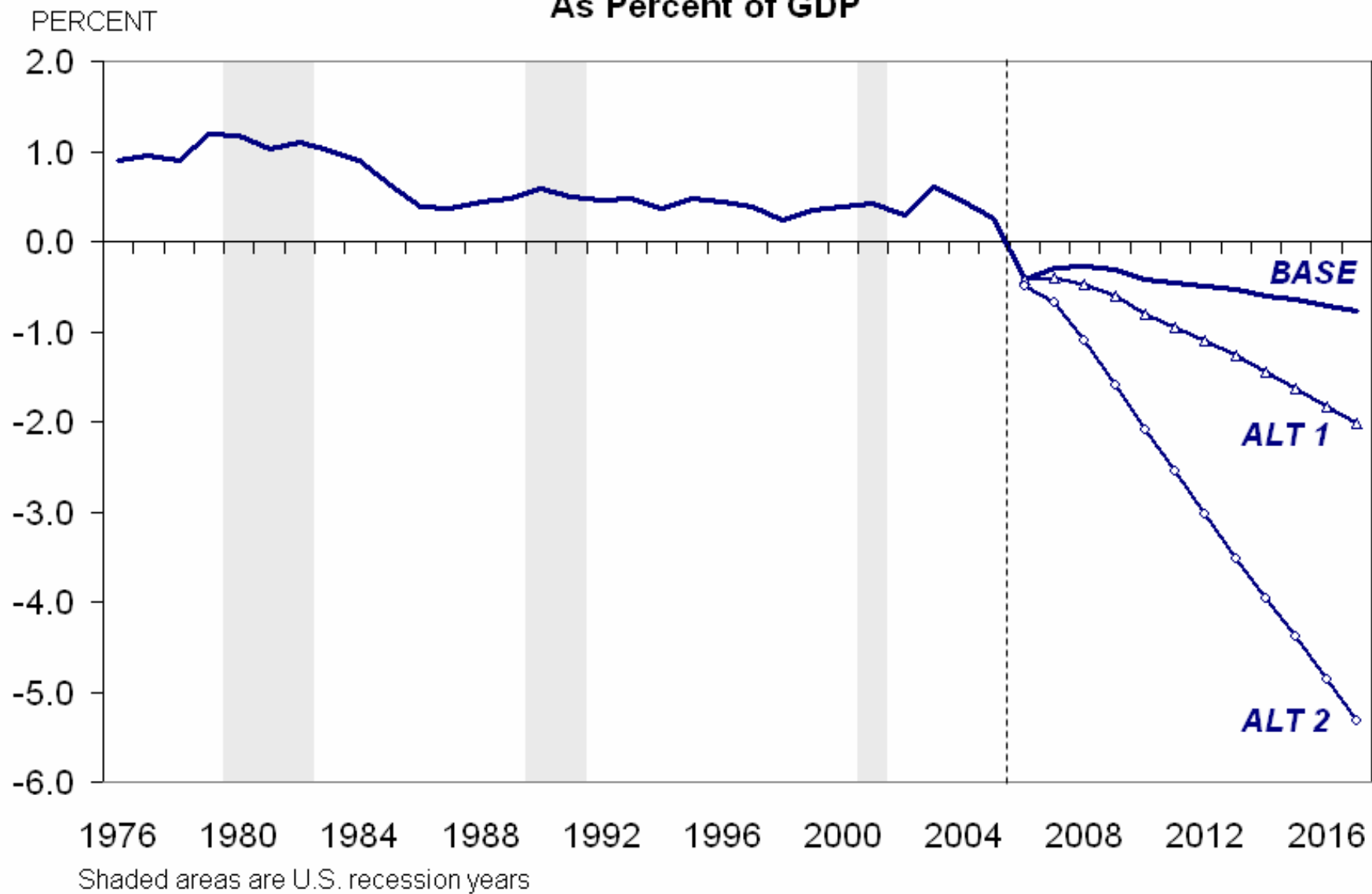


Shaded areas are U.S. recession years.

Derived U.S. Net International Investment Position

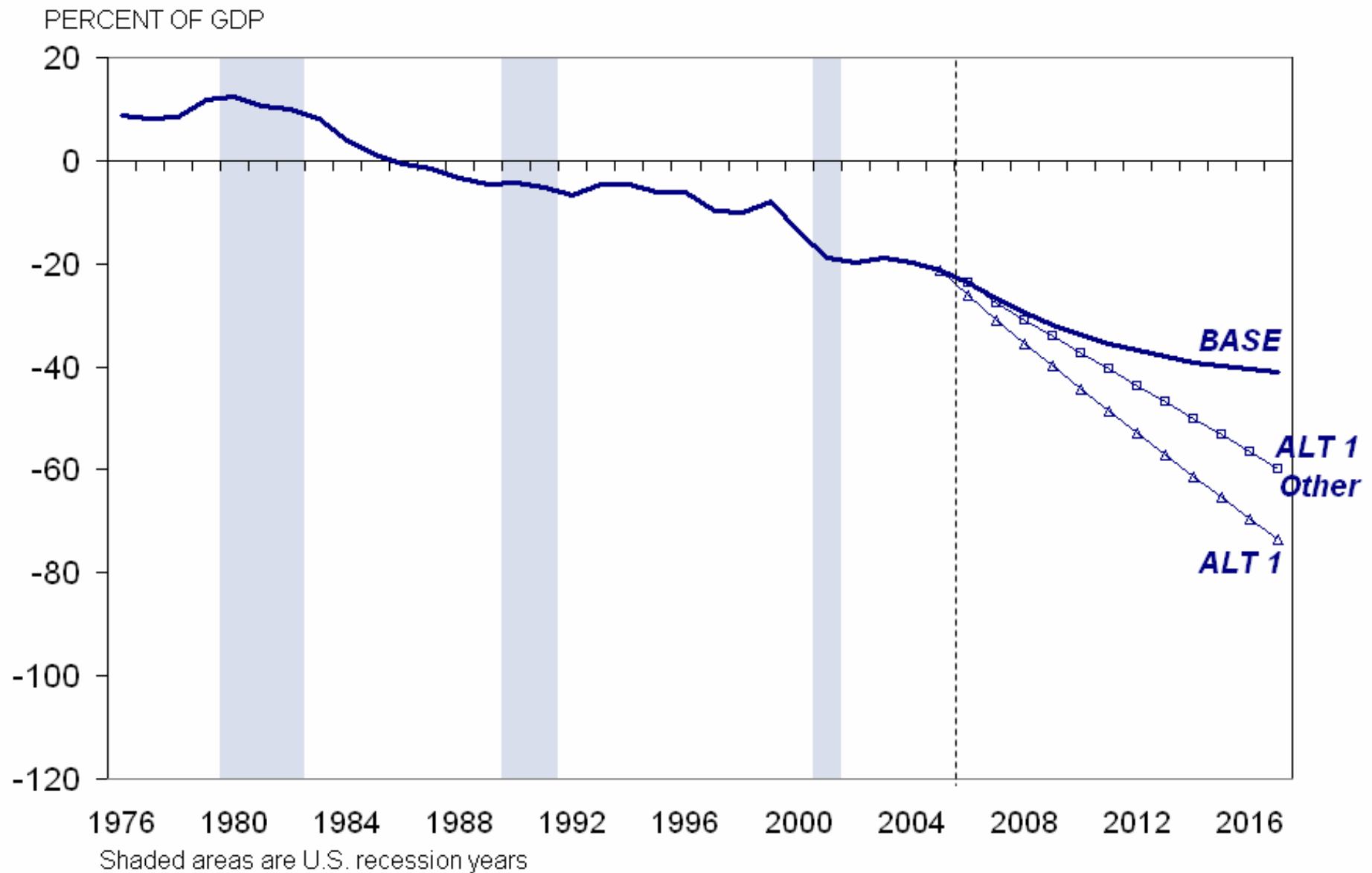


U.S. Net Factor Income Receipts (NIPAs) As Percent of GDP

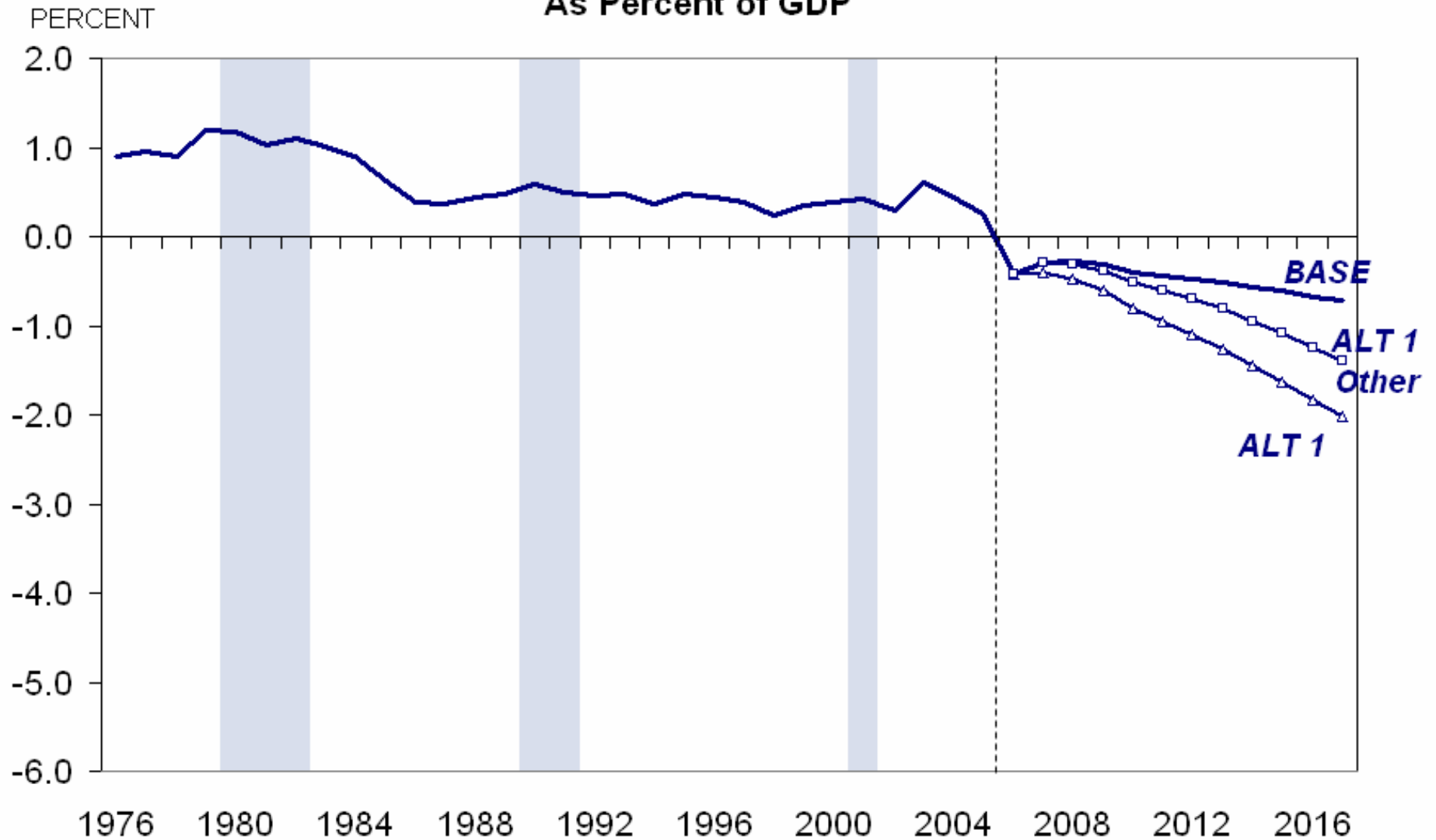


What if “Other” Valuation effects in ALT 1?

Derived U.S. Net International Investment Position



U.S. Net Factor Income Receipts (NIPAs) As Percent of GDP



Shaded areas are U.S. recession years

SUMMARY:

Conventional wisdom generally has been that it is inevitable that we will see ever-increasing “cost” of (net) income flowing abroad to service U.S. growing net international debt position.

In contrast, current private expectation for trade deficit improvement coupled with persisting historical relationships for rates of return and asset valuation effects indicate a much more manageable outcome with relatively low “cost” of (net) income flows abroad despite some additional increases in net debt.