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Comment

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Curcuru, Thomas, and Dvorak's paper provides an in-depth discussion of the problems with the official data that depicts one of the greatest mysteries of modern macroeconomics, namely, that the net international investment position (IIP) of the United States does not seem to be deteriorating significantly, although the country is running very large current account deficits.

The paper also argues convincingly that one can discriminate among various "theories" or rather "stories" about the mystery based on a careful evaluation of the relative reliability of data on various subcomponents of the international accounts (the stocks [IIP], the flows of asset accumulation, and the returns).

The authors' analysis suggests that the dark matter story fails since it is built on the assumption that the data on investment income are the most reliable and accurate item in the balance of payments, whereas in reality investment income is largely estimated.

The paper describes in considerable detail the authors' views on how the official U.S. statistics concerning the current account and the U.S. IIP should be adjusted to reflect reality.

The paper concludes that after plugging various holes in the accounts, the authors find that the positive returns differential the United States earns on its net IIP is much smaller than implied by the exorbitant privilege theory. They thus take a more open stance on this later view, which implies that the United States can run much larger current account deficits because it receives a higher return on its investments abroad than it pays on its investment liabilities. The authors do not emphasize this, but the "exorbitant privilege view" is similar to the "dark matter view" in that both have at their basis a high return differential. The difference between these two views lies essentially in the way the income investment data are reconciled with the data on the stocks of

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assets: in the dark matter view, only income returns are used to infer the value of the stock of (net) assets (which, since they do not show up in the statistics, are called "dark matter"). In the exorbitant privilege view, the asset data are mixed with the income return data using heroic assumptions about the nature of large statistical discrepancies in order to calculate "overall return" (essentially the sum of reported returns plus any changes in asset values).

Curcuru et al. undertake a massive effort to create more reliable data in order to be able to arrive at more accurate estimates of rates of returns on U.S. foreign assets and liabilities. However, as their conclusion, mentioned above, shows, they can only partially reduce the mystery and thus hold their ultimate judgment. The one firm point taken in the paper is, however, that the revised position data presented here are the most reliable statistics.

One first comment is that the authors start, naturally, with the latest available crop of data from the Bureau of Economic Analysis (BEA). This is unavoidable but risky since these data will be subject to important revisions. Any attempt to produce better estimates of investment income and to reconcile the data on IIP and transactions is thus like the labor of Sisyphus: it is bound to yield only temporary results since the baseline is shifting continuously.

A first important revision has already become available since the authors finished their paper. In the latest release of the BEA (as of June 17, 2008),[1] the net U.S. IIP as of the end of 2006 is put at US$2.225 billion, about $370 billion less than assumed in the paper (see their table 2). A difference of $370 billion in the net U.S. IIP is certainly not minor. To put this number into perspective, one might note that that the authors state that with their adjustments they arrive at a cumulated statistical discrepancy that ranges from $276 billion to $555 billion. The 2008 revision to the end of 2006 U.S. IIP alone could thus strongly affect the conclusions. But the key point here is that the 2008 revision is unlikely to be the last one.[2]

Even data further in the past is subject to frequent revisions, as table 1 shows. This table concentrates, as an example, on just one item of the U.S. IIP, namely, direct investment (DI) for 2002 and 2003 as it was reported by the International Monetary Fund in its balance of payments database on CD-ROM. The table reports the data found on the January 2005 and the May 2008 editions of this series of CD-ROMs. It is apparent that the data were substantially revised between 2005 and 2008. If Curcuru et al. had done their analysis in 2005 (using the data available as of January 2005), they would have assumed that U.S. DI abroad was

Table 1
Comparison of Different Vintages of U.S. IIP Data

	Old (2005 Vintage)		New (2008 Vintage)	
	2002	2003	2002	2003
DI abroad	2,039.78	2,730.29	1,867.04	2,054.46
DI in reporting economy	2,025.35	2,435.54	1,499.95	1,580.99

Source: International Monetary Fund, CD-ROMs, "Balance of Payments." "Old" means data from the May 2005 CD-ROM; "new" means data from the May 2008 CD-ROM.

worth $2.730 billion as of the end of 2003. Redoing their analysis with the 2008 vintage of data, they would have to assume that U.S. DI abroad was much smaller, only $2.054 billion. Even if the investment income data were not revised, this revision in the stock data alone would have necessitated large revisions in the estimated rates of return.

Data revisions are a fact of life for empirical research, but in the case of the U.S. international accounts, they are not only an order of magnitude larger than for other macroeconomic variables, they also continue for a long time and have a systematic tendency (bias?). Many revisions to the U.S. IIP data find that foreign assets in the United States are smaller than previously estimated and vice versa for U.S. assets abroad, which are usually subsequently found to be larger than previously estimated (DI represents an exception to this). There is a simple reason for this tendency. As the BEA casts its net ever wider in the search for institutions that might hold assets abroad, it is only natural that it tends to find over time more and more U.S. assets abroad. At the same time as foreigners continuously shuffle around their holding of U.S. assets, it is likely that in this process the U.S. authorities (and the global custodians on whose data the BEA relies) lose track of the foreign ownership of some assets. Moreover, there are entire asset classes, for example, shares in hedge funds registered in tax havens, for which it is close to impossible to establish the ultimate "beneficial ownership." The hedge fund itself might be registered in the Bahamas. Its holdings of U.S. assets would be classified as foreign owned, but in reality most of the owners of the hedge fund (formally often a partnership) might be U.S. citizens whose holdings of a partnership share in the hedge fund would not be registered by the usual surveys.

Curcuru et al. do not discuss this bias in revisions and concentrate instead exclusively on adjusting the (for them, current vintage of the) U.S. IIP and income data. In their adjustments they emphasize some aspects (e.g., underrecording of exports) that seem much less plausible if one does not look only at the United States. A good example is the

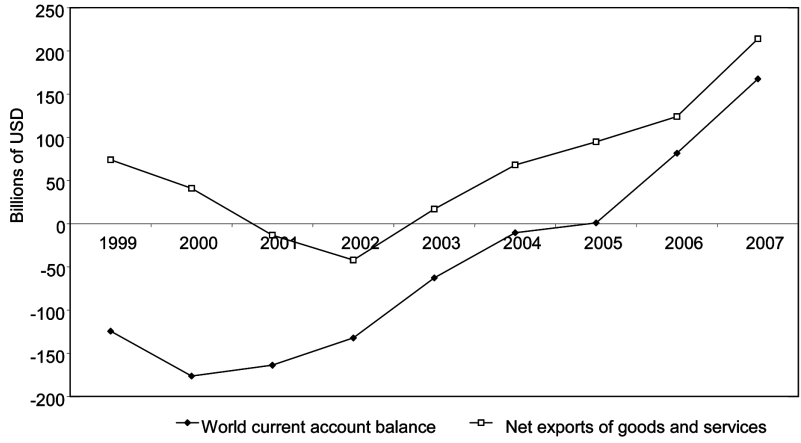

Fig. 1. World trade and current account (im)balances

argument that exports are underreported relative to imports because imports are subject to tariffs. However, this argument should cut both ways: with ad valorem imports as the rule, one would expect that traders have an incentive to report lower values for imports (but could be relaxed about declaring exports). The authors motivate their discussion by examples from mirror statistics, that is, the imports from the United States declared by its partner countries. However, the specific examples given (Canada) do not seem to justify a general rule. A check by the author on German data found that German exports to the United States (as reported by German statistical authorities) are identical (to 99%) to the imports as reported by the U.S. authorities.

Another way to check the argument that there might be systematic underreporting of exports is to look at the global discrepancy between reported exports and imports (which at the level of the world economy should be equal). Figure 1 shows that while in the past it might have sometimes been true that imports were overreported, this is no longer the case, at least on average across all countries. In 2007 the reported difference between exports (of goods and services) and imports was over $200 billion, or around 1.3% of total reported exports. It is difficult to see why the United States should be subject to the opposite phenomenon (as argued by Curcuru et al.). Hence, it is difficult to accept the large revisions to U.S. exports imposed on the data by the authors.

A similar comment applies to the current account. Until about 2004/5 the global current account balance was usually negative and there was a large difference between the discrepancy on trade (in goods and services)

and the current account. This suggests that, on average, at least until 2005/6, unilateral transfers and payments on foreign liabilities were overreported (at least relative to the reporting of receipts of transfers and receipts on foreign income). Over time the difference between the reported global "balance" on the current account and goods and services has narrowed considerably, suggesting that the measurement of income receipts must have improved.

It is difficult to argue with the many other detailed revisions to the stock and return data that Curcuru et al. propose. What is really surprising is, however, that there is no in-depth discussion of DI return data. The authors seem to assume that DI data are more reliable than other data because DI data are collected at the firm level, not estimated. However, there are a number of indications that both the stock and the return data for DI contain a large bias.

The one key element in the (reported) difference between the rates of returns on U.S. assets and liabilities is the item "reinvested earnings." It is somewhat surprising that the authors do not comment on this key item in their section of estimated return differentials given that the positive U.S. income account results essentially from the data reported for reinvested (or retained) earnings. Both the dark matter and the exorbitant privilege views are primarily the result of a gaping asymmetry in this item: Although all sources suggest that foreign DI in the United States is of an order of magnitude similar to that of U.S. DI abroad, the U.S. income accounts contain almost three times as much in DI income receipts ($370 billion) as in DI income payments ($130 billion, both 2007 data). This discrepancy should have been mentioned and its reliability should have been evaluated carefully. Doubts about the reliability of the reported DI income data would have provided additional support for the authors' conclusion that the measured return differential is not so large as to eliminate all concerns about the sustainability of the U.S. external position.

A paper on the relative reliability of international accounts would have benefited from some cross-country evidence. The data for the euro zone are especially interesting in this context. It is not widely appreciated that the net IIP position of the euro zone is of an order of magnitude similar to that of the United States. The European Central Bank reports that as of the end of 2007, the euro zone had a net debtor position of €1.330 billion, equivalent to over $2.000 billion (by comparison the U.S. net IIP, as reported by the BEA for the end of 2007, amounts to about $2.400 billion). As table 2 shows, the net IIP of the euro area has deteriorated by about $1.500 billion during the last 8 years for which

Table 2
Cross-Country Evidence of the Relative Reliability of International Accounts (Billions of U.S. Dollars)

A. Consistency between Flows (Current Account) and Stocks (IIP): Cumulated Current Account Balances and Changes in the Net IIP (1999–2006)

	Cumulated Current Account (1)	Change in Net IIP (2)	Gap (Col. 1 − Col. 2)
Euro area	9	−861 (−1.500)*	1.509
Japan	1.079	655	424
United Kingdom	−321	−405	84
United States	−4.292	−1.644	−2.648
Russia	409	−59	350

B. Consistency between Stocks (IIP) and Returns: Net IIP 2006 and Net Income

	Net IIP	Net Investment Income	Rates of Return	
			Assets	Liabilities
Euro area	−847.0	10.5	4.4%	−4.1%
Japan	1,808.2	118.2	3.9%	−1.7%
United Kingdom	−599.0	34.9	5.3%	−4.7%
United States	−2,539.6	43.2	5.6%	−4.4%
Russia	−63.2	−25.2	5.6%	−9.7%

Source: Own calculations on International Financial Statistics balance of payments data.
*Until the end of 2007.

data are available, although its current account has been roughly in equilibrium over this period. The euro area thus shows a "gap" more than 60% of that of the United States (and of an order of magnitude similar to the one shown in Curcuru et al.'s fig. 3), but with the opposite sign.

For the euro zone the phenomenon to be explained is thus the opposite of that for the United States: How could the euro zone become such a large debtor without ever running significant current account deficits? Panel A of table 2 shows that other large economies also show large gaps. It seems that the correlation between the current account and changes in net asset positions is rather weak in general, and not just for the United States.

However, in another sense the euro zone is similar to the United States since the euro zone also benefits from a small "exorbitant privilege" because its investment income account is balanced despite the huge net debtor position. This is possible because the recorded rate of return on the foreign assets of the euro zone is 3.9%, somewhat higher than the rate of return paid on its foreign liabilities (3.6%). This differential is not much

different from the lower end of the range estimated by the authors for the United States. Moreover, as panel B of table 2 shows, other large OECD economies (such as the United Kingdom and Japan) also seem to enjoy an exorbitant privilege. The data for Russia show the opposite phenomenon (rates of return on liabilities much larger than on assets), suggesting that emerging markets might provide the counterpart to the exorbitant privilege apparently enjoyed by most OECD economies, and not just the United States.

Endnotes

Many thanks to Selen Guerin for helpful discussions and ideas.

1. See http://www.bea.gov/newsreleases/international/transactions/transnewsrelease.htm.

2. This is also suggested by the introductory text of the press release of the BEA of June 17, 2008, which states that "As is customary each June, estimates of U.S. international transactions are updated and revised to incorporate newly available source data and improved estimating methodologies" (http://www.bea.gov/newsreleases/international/transactions/transnewsrelease.htm).