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P. I. Nwaoba
Central Bank of Nigeria

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STEPHEN A. MEYER: "THE U.S. AS A DEBTOR COUNTRY: CAUSES, PROSPECTS AND POLICY IMPLICATIONS." *BUSINESS REVIEW.* FEDERAL RESERVE BANK OF PHILADELPHIA, NOVEMBER/DECEMBER, 1989 (13pp)

The author's focus in this paper is the analysis of the implications of increased net debt claims on the United States. In his opinion, while net inflow of foreign investment is welcome, there is the fear that excessive net claims on a country like U.S.A. may constitute a problem in the long-run. The author's concern centres on the probable adverse consequences of the growing status of U.S.A. as a net debtor nation and the implication for future generations of Americans in terms of standard of living and debt service burden. It is the author's view that this might also lead to very high inflation rates, like those experienced recently by some debtor nations. The paper therefore seeks to analyse the validity of these concerns by first discussing the economic factors that generated large capital inflows into the country and evaluating the prospects for reversing this net-debtor position. This it does by weighing the role economic policies can play in the process.

Having identified the bulging current account deficit as the major cause of the net-debtor position of the United States, the author goes further to analyse contending gains and disadvantages of the position. He establishes that the U.S. has been running a current account deficit since 1982 when her receipts from abroad began to fall short of her payments to foreigners. Expectedly, these deficits and the subsequent capital inflows during the 1980s, which resulted mainly from the short fall in real investment funds, created macro-economic imbalances. The author does not see a net-debtor status as a liability if new inflow of capital is used for productive investment. He argues further that subsequent debt service payments on net inflow of capital may in fact be lower than the increase in Gross Domestic Product and gain in net capital formation. However, he concedes that if investment is chanelled into unproductive ventures, consumption and government deficit financing, the result may be a lowered standard of living and an increased debt service burden.

The author, however, warns that the pursuance of expansionary monetary and fiscal policies could result in adverse consequences if inflation is fuelled. In this case, short term interest rates could rise to match the inflation rate and thus increase the debt service burden. If prudent management of the economy is pursued, especially if taxes are raised to finance government deficits, there may not be an acceleration of inflation. However, the author concludes that monetary policy could be relaxed when fiscal restraint has been achieved, national savings has been increased and demand for goods and services has been moderated.

Much as the author's view follows contemporary expectation, it is my opinion that net claim on the United States cannot be equated with outstanding external indebtedness. The fact that the value of foreign investment in the U.S. is more than foreign investment by her citizens abroad does not suggest an adverse position for the U.S. It is in fact beneficial to the balance of payments as it represents net inflow of funds. Furthermore, U.S. investments abroad may yield a higher net inflow relative to foreigners investment in the U.S., although these may carry historically higher book value. The valuation of assets and liabilities if done on a common basis with appropriate valuation adjustment would even suggest a favourable position for the U.S.

The suggestion by the author that the debtor position was caused by deficits in the current account due to the short fall in savings relative to investment may not hold. It is true that foreign debts could be acquired when savings are lower than investment to finance current consumption and as such a gap may develop in the current account of the balance of payments. If such a gap is in the merchandise account, the capital account would also record a credit balance of the same amount. On the other hand, if the inflow is for investment purposes, the capital account would record a credit and the counterpart debit would be accommodated in reserves.

The suggestion that monetary policy could be relaxed when fiscal restraint has been achieved, national savings has increased and demand for goods and services is growing less rapidly may not be a right policy. At all times, a non-inflationary monetary policy should be pursued so as to avoid a situation where inflation is aggravated.

The review has succeeded in showing that capital inflows are beneficial to both investors and recipients, depending on the movement in net resources. The author's incisive analyses, in spite of some pitfalls, is highly commendable.

PETER I. NWAOBA
ASSISTANT ECONOMIST
RESEARCH DEPARTMENT