Executive Memorandum
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THE U.S. AS A DEBTOR NATION: WHAT IT REALLY MEANS

Last week the media announced that for the first time in nearly 70 years the U.S. is a net debtor country. The impression given was that the U.S. has become another Mexico or Argentina, tottering on the edge of financial collapse. But like many such simplistic interpretations of the facts, that impression is a fallacy.

The reason for the hysteria is that foreigners now have investments of over $900 billion in the U.S., whereas American investments overseas are now slightly below that amount. Hence the picture of America living on borrowed money. Yet this "indebtedness" actually results from a massive vote of confidence in the American economy by foreign investors. Strangely, when a business is actively pursued by willing investors, it is taken as a sign of strength. When foreigners put their money in American industry, however, there is concern that the U.S. has become a "debtor nation."

Industrial development in America has often been heavily dependent on foreign investments. It was British capital that financed much of the westward expansion of the railroads. The U.S. only became a net lender when, to finance World War I, the European powers were forced to sell many American investments.

Foreigners have again concluded that America is a much better investment opportunity than their own sluggish economies. Led by Britain, the Netherlands, Canada and Japan, overseas investors have put nearly $300 billion into U.S. factories and businesses, real estate, and privately owned stocks and securities, creating 8 million American jobs. The Japanese, for instance, recently built a Honda auto plant in Tennessee.

In addition, Americans are now keeping more of their own investment dollars at home. In 1982, during the recession, net new U.S. investments overseas peaked at $119.2 billion. In 1983 the amount dropped to $55 billion and in 1984 to $20.5 billion. It is this choice by Americans to invest more of their capital in U.S. business, in fact, that is the principal cause of America's "debtor" status. Yet when Americans send capital overseas and foreigners shun this country--making the U.S. a net creditor--the complaint has always been that America is "exporting jobs."

Being a debtor nation, of course, can still be undesirable. Contrast Argentina with South Korea. Both countries have an international debt of approximately $45 billion. But the government of Argentina borrowed billions of dollars to pour into unproductive state industries. Most South Korean borrowing, on the other hand, went into productive private investments, giving that country one of the healthiest economies in the Third World. So indebtedness can spell trouble if it is used simply to bail out bad economic policy.

Some policy makers maintain that this is the case in the U.S. They point out that as the federal budget deficit grows, more foreign funds are borrowed by the government to finance the budget gap. There is also concern that foreign money collecting interest in U.S. banks could be pulled out at the first sign of economic problems, causing a large capital outflow and a financial crisis.

But while there has, indeed, been a net increase of foreign funds used to purchase U.S. Treasury securities, the percentage of U.S. debt owned by foreigners dropped from 26.2 percent in 1978 to 15.9 percent in 1984. On the other hand, net new foreign capital going into direct private investments rose from $12 billion in 1983 to $22.5 billion in 1984. Moreover, U.S. liabilities reported by U.S. banks (the "hot" money that many fear might be pulled out at a moment's notice) has dropped as the economy recovered, declining from $65.9 billion in 1982 to $31.7 billion in 1984. A growing percentage of foreign money is now in direct, job-creating investments as opposed to bank accounts.

The high level of government borrowing is indeed a legitimate concern, but there must be no mistake about the best solution to the overall deficit problem. If taxes are increased, in an attempt to reduce the budget deficit, the U.S. economy will be less attractive, and both foreign and American capital will flow out of the country. It should be remembered that during the Depression the U.S. was not a net debtor nation. And for one simple reason: no one wanted to invest in the stagnant American economy.

Thus America's new status as a "debtor" country is not, of itself, a matter for concern, since it means that the country's economic strength and stability are attracting foreign investors and keeping American capital at home. This boosts the economic base and creates new jobs. To the extent that bloated government absorbs that capital, whether in the form of borrowing or taxes, action is needed. But the solution is to cut down the size of government, not to make America's economy unattractive to foreigners.

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For further information:

Robert J. Samuelson, "Uncle Sam as Debtor," The Washington Post, February 20, 1985, p. D1.

Herbert Stein, "My Foreign Debt," The Wall Street Journal, May 10, 1985, p. 24.