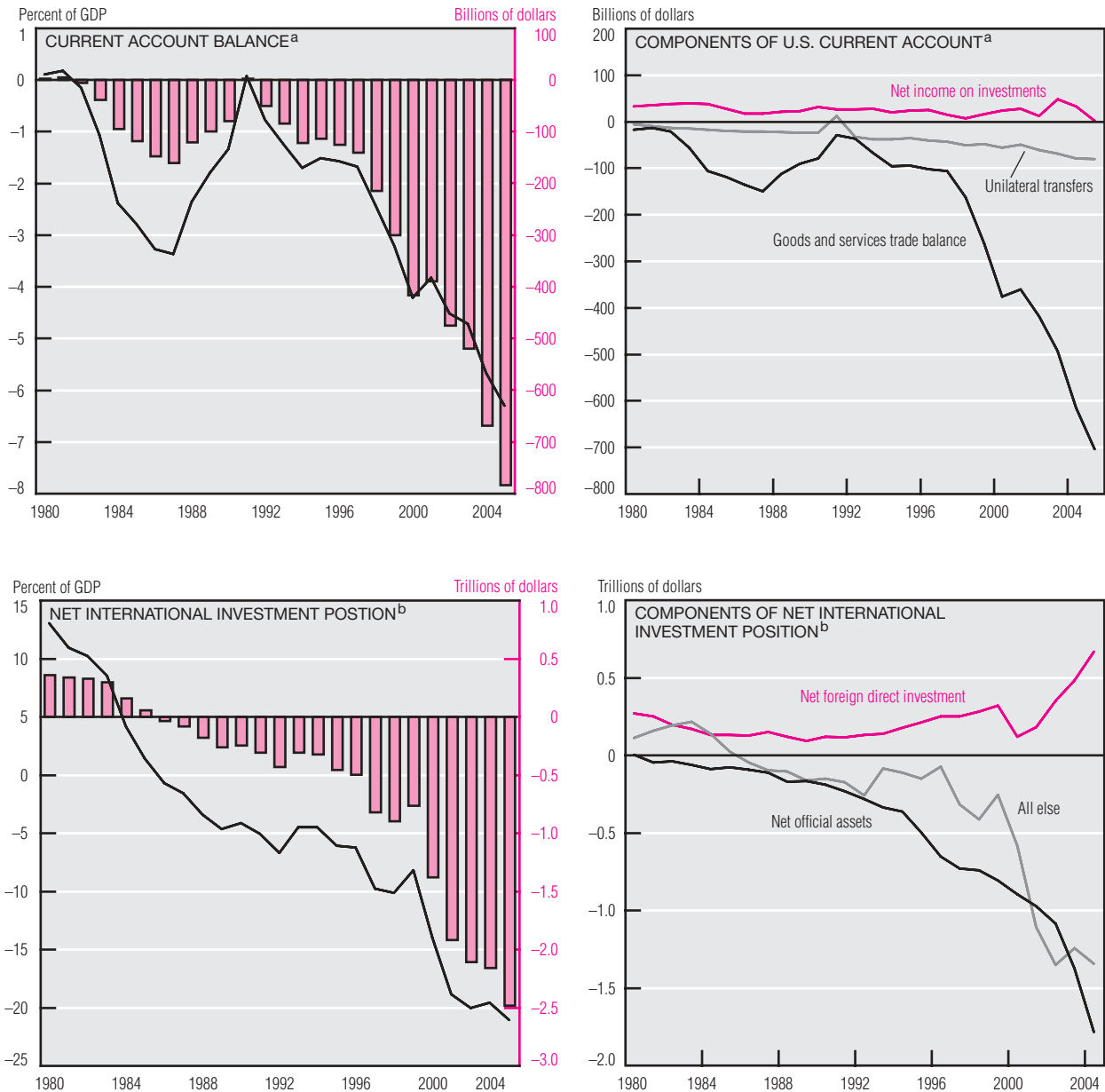


Dark Matter and the International Payments Problem



a. 2005 is estimated using data from the first three quarters.

b. With direct investment on a current-cost basis.

NOTE: See Ricardo Hausmann and Federico Sturzenegger, "U.S. and Global Imbalances: Can Dark Matter Prevent a Big Bang?" (November 13, 2005) http://www.cid.harvard.edu/cidpublications/darkmatter_051130.pdf.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

A 23-year string of current account deficits has left foreigners holding substantial—and still growing—financial claims against the U.S. Although this pattern seems unsustainable, those who perennially predict a bone-jarring correction have so far been wrong. Recently, economists Ricardo Hausmann and Federico Sturzenegger suggested that no reversal has taken place simply because none is needed. They claim that international accounts do not measure

certain intangible U.S. assets, which they call dark matter. Accounting for dark matter virtually wipes out the threatening imbalance.

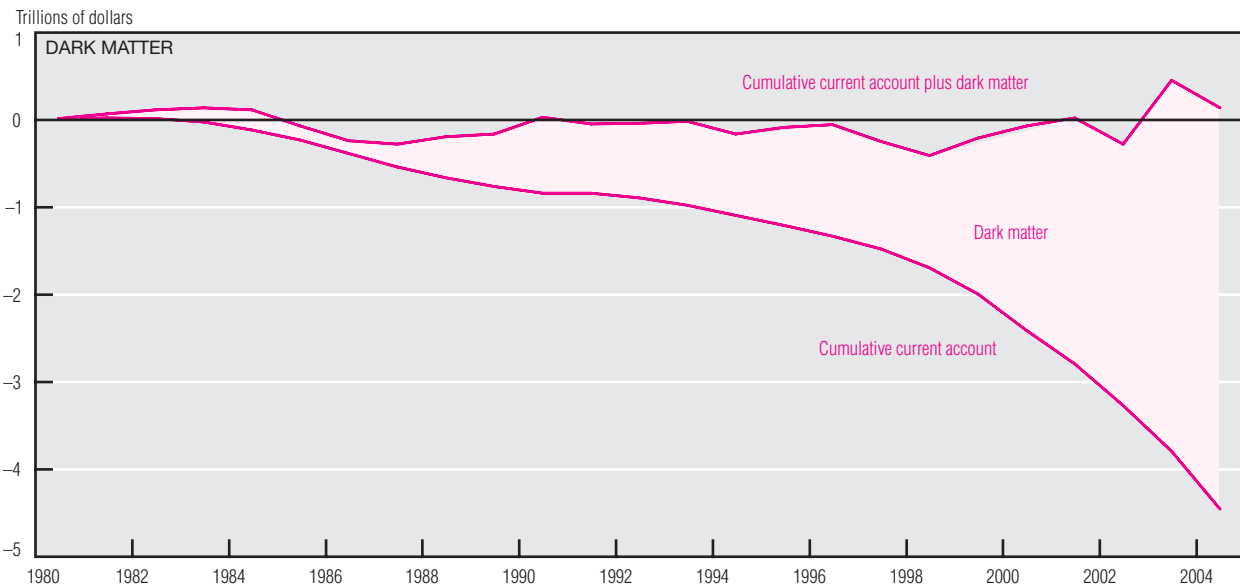
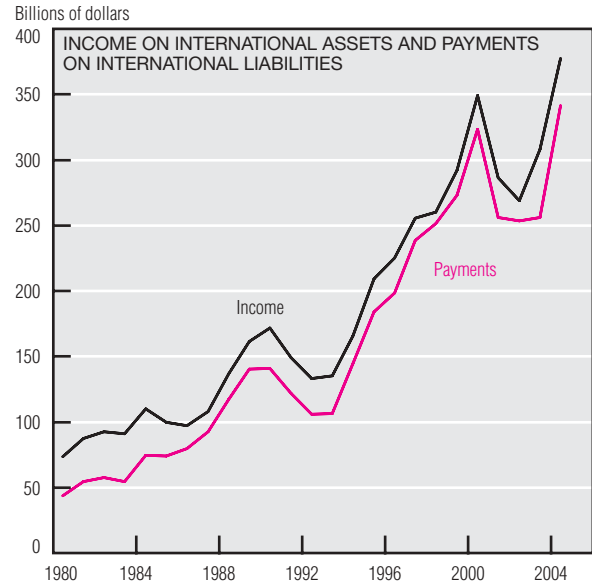
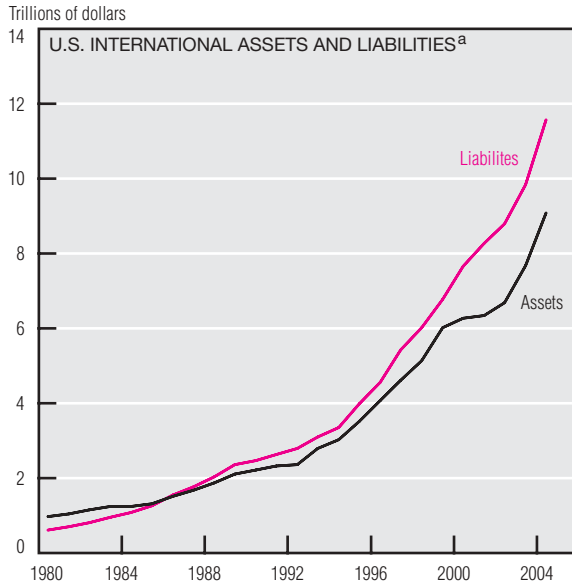
When a nation imports more than it exports, it finances the difference by issuing net financial claims to the rest of the world. Because of our persistent trade deficit, by 1986, outstanding foreign claims on the U.S. began to exceed our claims on the rest of the world, giving us a negative net international investment position.

In 2004, our negative net international investment position grew to \$2.5 trillion or 21% of GDP. These claims cannot rise indefinitely relative to GDP, which is a standard proxy for our ability to service them.

Despite our large and growing negative net international investment position, U.S. residents' income from assets that they hold abroad is consistently higher than foreigners' income from claims that they hold on the U.S. This seems anomalous to Hausmann

(continued on next page)

Dark Matter and the International Payments Problem (cont.)



a. With direct investment on a current-cost basis.

NOTE: See Ricardo Hausmann and Federico Sturzenegger, "U.S. and Global Imbalances: Can Dark Matter Prevent a Big Bang?" (November 13, 2005) http://www.cid.harvard.edu/cidpublications/darkmatter_051130.pdf.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

and Sturzenegger, who contend that any asset that consistently pays more than another must be worth more. Accordingly, they revalue our net international investment position and find that the implied cumulative current account deficit virtually disappears. They attribute the resulting difference to dark matter, which they trace to three sources.

First, U.S. foreign direct investments often infuse operations abroad with business acumen, financial know-how, and a brand name, which raise their

value in nonmeasurable ways. Second, when the U.S. issues safe Treasury securities to the rest of the world and buys higher-yielding—but riskier—emerging-market debt, the transaction is tantamount to the sale of insurance whose value is only captured in the rate differential. Similarly, foreigners hold cash and other liquid dollar-denominated assets in exchange for less-liquid but higher-yielding assets. The rate differential reflects the value of exported U.S. liquidity services that we otherwise fail to measure.

Extending their analysis to other countries, the authors find that, with the exception of Japan, the world is more closely in balance than previously thought. Japan remains a substantial net creditor, while the European Union and the rest of the world have small negative net international investment positions.

The idea of dark matter is controversial, but its focus on intangibles and measurement issues might explain why the oft-predicted current account crash has not yet become visible.