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What's wealth got to do with it? Global balance sheets and US geo-economic power

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ABSTRACT

Does the ever-increasing stock of cross-border asset holdings pose a threat to macro-economic stability and to US geo-economic power? Recent analyses suggest that exchange rate changes might drive massive changes in net asset positions that in turn create equally large wealth effects. These wealth effects might compromise US macro-economic policy. In contrast, this manuscript argues that these fears are misplaced. Income flows are the dog that wags the asset tail. Those income flows in turn derive from differences in national growth rates and in the ability of firms to capture profit from global value chains. Expectations around these flows validate asset values. Attention should therefore focus on the source of flows and control over flows, particularly profits, rather than on asset stocks, which are a dependent variable. Although wealth effects driven by exchange rate changes are large, other routine changes in flows and expectations have similar or larger effects on the stock of wealth.

KEYWORDS International monetary system; exchange rates; investment; geo-economics; wealth effects

What's national financial wealth got to do, got to do with geo-economic power? What's financial wealth but a second-hand form of power? Financial wealth after all is simply the capitalized value of a given stream of current income and – crucially – expectations about the degree to which that income stream will continue into the future. Nonetheless, several major analyses argue that changes in asset values redistribute wealth globally with potentially negative consequences for US power, US macro-economic policy autonomy and US ability to retain the dollar's centrality in the International Monetary System (IMS). These analyses claim that quantity has a quality all of its own: the enormous gross holdings (*stock*¹) that now characterize accumulated inter-OECD asset positions have effects independent of any given investment or income *flow* in the current account. Put simply, for these new balance sheet arguments (NBSA), the scale of asset stocks means that US dollar exchange rate appreciation versus the currencies in which its major foreign assets are denominated reduce US wealth to a considerable and meaningful degree; conversely, decreases in the dollar exchange rate increase US wealth in a meaningful way as the value of US foreign currency assets rises relative to its dollar-denominated liabilities.

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The NBSA make three claims. First, the persistent US current account deficit is overall bad for the US economy and US power because of the continuous erosion of the US net international investment position (NIIP). Second, fluctuating exchange rates affect the value of the large gross international investment positions accrued over the years. These fluctuations can cause transfers of wealth significant enough to affect US macro-economic policy via negative wealth effects and/or diminish US global economic power by making private foreign investors skeptical about holding US assets. Third, implicitly, the capital account dominates the current account, in the sense that investment flows have created gross international investment positions so large that valuation changes can dwarf trade flows. The stock tail now wags the flow dog.

Arguments that national balance sheets matter are only partially correct about the mechanisms and magnitude – about how and how much – financial asset stocks matter. Most generally, capitalism is a system of flows. The new analyses concerned with stocks select an outcome of this system of flows in order to argue that stocks now matter more than flows, and that exchange rates bear heavily on the value of global stocks of assets. But wealth is mostly a dependent variable whose independent variable is current and even more so expected income flows. Those income flows in turn reflect power in its most basic forms: profits in a capitalist economy, and behind those profits the ability to structure the day-to-day lives of people and assure compliance with elite projects – minimally Michael Mann's (1984) infrastructural power or maximally Michel Foucault's (1980) capillary power. That said, existing wealth can be used preemptively to capture potentially fast-growing streams of income, and even more obviously to persuade politicians to reward or redirect specific flows of income.

'Hype' and contagion do affect actors' perceptions and expectations about profit flows and thus value (Harmes, 1998; Nitzan, 1998; Veblen, 1904). Adjudicating the debate between the efficient market hypothesis and a purely social theory of value (Knorr-Cetina & Preda, 2007) is impossible here. For my purposes, it is sufficient to assume that actors operate with bounded rationality. This bounded rationality implies that most actors operate within conventional categories that take for granted in an unproblematic way the meaning of concepts like gross domestic product (GDP), national economy, balance of payments and internally homogeneous and unified corporations, as well as the utility of data generated by and pertaining to those concepts. Recent research has questioned the degree to which these concepts are unproblematic and the degree to which these data actually measure what they claim to measure (see Linsi & Mügge, 2017 and the on-going OECD-World Bank TiVA project on the balance of payments data; the on-going CORPNET project [corpnet.uva.nl] on corporate structures, FDI and tax havens; and, an early intervention, Palan, 2006 on the way corporations structure themselves 'offshore'). The argument here has even more force if any of those critiques are true, as the purported wealth effects become more diffuse.

Second, with respect to exchange rates, the old issues of original sin, debt intolerance and currency mismatch persist (Eichengreen & Hausmann, 1999; Eichengreen, Hausmann, & Panizza, 2007; Hausmann, 1999). But these issues also reflect underlying power dynamics around income and investment flows. Countries are not households bound by a hard budget constraint if they can issue debt (including money) in their own currency and have that debt accepted by domestic

and foreign actors. Actors accept (or reject) new debt and currency based on their expectations about future flows, including their tax obligations to a given sovereign. This is the essence of monetary power (Mehrling, 2010), and in turn that reflects the issues Mann and Foucault raise.

Third, with respect to specific claims, the US current account deficit overall has positive effects for the global economy, even if it has considerable negative domestic effects because of its distributional consequences. The US current account deficit is large enough to have global macro-economic significance. From 1992 to 2017 the US current account deficit averaged 0.79% of global GDP (IMF, 2018) or about \$380 billion per year. Contrast this with the 2009–2010 Obama stimulus (American Recovery and Reinvestment Act, 2009) at roughly 2.6% of US GDP and \$400 billion per year. On the one hand, the US current account deficit helps drive global growth and prevent 1930s-style debt deflation or 1880s-style persistent deflation. On the other, the distributional consequences create a mixture of positive and negative outcomes. The US current account deficit and its related extra growth valorize the profits of US firms, helping them maintain their dominant global position. It also ties the profitability of foreign firms to the fate of the US economy, reinforcing the dominant political coalition in export-driven economies (Schwartz, *in press*). Finally, this growth maintains the value of accumulated stocks of wealth because its profit flows validate equity prices and its wage and other income flows validate real estate prices in areas with population inflows.

On the other hand, US workers in firms exposed to international competition have been big losers in terms of jobs and wages; likewise export-led economies depress domestic consumption in order to maximize export surpluses. Höpner (2018) shows this for Germany, where growth in final domestic demand in real terms has varied between one- and two-thirds of the US and OECD average level since 1993. In general an undervalued exchange rate implies lower consumption by deterring imports and shifting output towards exports. On balance the US current account deficit produces positive economic and political effects, if – a big if, as the rise of anti-immigrant parties based on economic losers in a given country's ethnonational core shows – the negative political consequences of trade deficits and stagnant wages can be managed domestically. Deflation would reduce the flow of income and profits and thus put downward pressure on asset values. The uneven distribution of profits and wage employment might be unambiguously problematic for moral reasons, but it is not unambiguously bad for powerful firms and the US state.

Summing up, US wealth and secondarily growth do not rest on hopes of positive valuation changes driven by a weaker exchange rate. They rest on the ability of US firms and US controlled entities to capture income and profits from global supply chains. Past performance of and expectations about income and profit flows determine the market value of the bonds and equities on the aggregate US balance sheet. Those income and profit flows also determine, more directly than aggregate wealth, foreign investor perceptions about the longer-term value of the dollar, the probability that it remains central in the global monetary system, and the degree to which the US economy will grow as fast or faster than other plausible sites for investment in and by rich, stable economies. Finally, these income flows, combined with the ability and willingness of the US state to extract resources through taxation, validate US public debt (including government guaranteed housing debt).

This public debt comprised 39% of US foreign liabilities as of June 2017 (US Treasury, 2018).

These three points have two major implications for NBSA. While changes in the exchange rate do change the relative value of assets and liabilities on the US international balance sheet, they matter less than both income and profit flows, and changes in domestic asset values. US dollar appreciation nominally worsens the US NIIP. But it also increases the consumption power of politically decisive slices of the US electorate, offsetting negative wealth effects; it increases the ability of some US firms to expand outward, strengthening those firms' hold on global commodity chains; and it encourages even more foreign investment by making the US an attractive location. Conversely, US dollar depreciation makes the US NIIP look better, but inverts all the positive consequences listed in the prior sentence.

Second, the capital account does dominate the current account, in the sense that specific domestic institutional structures producing national level choices between consumption and investment create exportable savings that in turn lead to changes in trade balances (Höpner, 2018; Pettis, 2014). But this points to the need for further research on how and why countries with a persistent current account surplus have domestic political economies that suppress domestic demand in favor of external demand, rather than looking at how the residual of those choices manifests itself in national balance sheets. Aggregated balance sheets conceal not only the real distribution of income and wealth in the relevant countries, but also the internal distribution of political power. This distribution shapes countries' adherence to a dollar-centric global monetary system as well as private actors' choices about what assets to hold. In short, the NBSA focuses on dependent rather than independent variables, on the manifestations of power rather than the causes of power.

The rest of the article fleshes out these points. Sections one and two discuss and then dismiss three different arguments suggesting that changes on the aggregate US balance sheet drive deleterious macro-economic outcomes or changes in relative power. Section three presents a positive argument for why persistent US current account deficits, a major source of the steadily worsening US NIIP, are a feature, not a bug, of the global monetary system. Section four turns to the issue of growth in general, and links this back to the issue of how the US obtains (or not) relative growth in a US-centric global economy. Section five concludes by reflecting on what is useful in a balance sheet perspective on global power.

Who needs the power from a bond when a bond can be broken?

Is wealth in the form of aggregate national foreign holdings of assets and liabilities a dependent or an independent variable? If it is an independent variable, what behavior does it affect, and what does it imply for a country's power or autonomy? The NBSA literature argues that it is an independent variable, largely operating through wealth effects and that these wealth effects constrain US monetary power.

The NBSA literature largely derives from economists' consideration of 'original sin' – the inability to borrow in one's own currency – in indebted developing countries (Allen, Setser, Keller, Rosenberg, & Roubini, 2002; Eichengreen & Hausmann, 1999; see also Jeanne & Zettelmeyer 2002; Lane, 2000; McGuire & von Peter, 2012; Obstfeld, 2012; Summers, 2000). This largely official literature addressed financial crisis management; the cited authors variously work(-ed) at the

IMF, Bank for International Settlements (BIS) or held other policy positions. After 2008, the analysis was extended to the rich countries. Though 2008 was a crisis primarily of bank balance sheets, exchange rate considerations also mattered for the spread of the crisis, because euro banks were caught with long dollar liability positions without any back-up. This sparked investigation into how vulnerable the rich countries were to these kinds of effects. But more political economy oriented authors, like the investment bankers Pettis (2001) and Dooley, Folkerts-Landau and Garber (2004) were already considering balance sheet issues ahead of the 2008 crisis, although their main concern remained developing economies.

Echoing Pettis (2001, p. xiii), Allen et al. (2002, p. 4) make a clear statement of the issue: 'The financial structure of many emerging markets economies – the composition and size of the liabilities and assets on the country's financial balance sheet – has been an important source of vulnerability to crises.' They identify four major mismatches: maturity, currency, capital structure (debt versus equity), and solvency. Of these, currency mismatch looms largest, reflecting developing economies' original sin (Allen et al., 2002, p. 27). If neither public nor private entities in developing countries can borrow in their own currencies, their future outgoes and liabilities are hard currency denominated while their future income streams and assets are largely local currency denominated. Thus a depreciating exchange rate promises first a liquidity crisis as external funders refuse to roll over loans, and then a solvency crisis if local hard currency reserves are exhausted in principal and interest payments on hard currency liabilities. Original sin countries are in fact like households or like companies, in that they cannot create money to satisfy their liabilities.

Yet this does not apply directly to countries with hard currencies, particularly the United States, as their states and banks largely borrow in their own currency (stats.BIS.org). Unlike original sin countries, the US central bank can create money to satisfy US entities' liabilities to foreign entities. Although a strict monetarist would argue that this should trigger massive inflation, experience suggests some caution about that claim. After 2008 the major central banks created roughly \$17 trillion in new money with virtually no inflationary effect. On the other hand, the eurozone crisis and the experience of chronically trade-deficit Australia, Canada and New Zealand shows the limits to this insouciance. In the latter cases, over the past 40 years, between one- and two-thirds of external debt was foreign currency denominated, and foreign liabilities were well above the levels signaling distress in developing countries (Schwartz, 1991). In the former case, developed countries gave up their ability to create money to a super-sovereign authority. All thus faced some currency constraint in the face of a perceived or actual crisis.

In the Anglo cases, policy makers fearing a crisis shifted foreign liabilities off the government balance sheet and onto private balance sheets, on the theory that consenting adults knew what they were doing (aka the Lawson or Pitchford Doctrines), and that private bankruptcy caused by exchange rate movements would have no systemic effects. But as the Eurozone crisis showed, private distress created by large gross balance sheet positions could snowball into a systemic crisis that shifted foreign currency debt – de facto the Eurozone situation given national governments' surrender of money creation to the ECB – onto the public balance sheet. These experiences suggest that rather than a strict divide between hard and soft currencies, a continuum of currency robustness exists, with the US dollar, Euro

(for all its faults) and Yen at the top, and with other, lesser currencies arrayed beneath (Cohen, 1998). But this means that balance sheet effects from exchange rate changes have to operate through a different mechanism in developed economies than the simple hard currency liabilities/soft currency assets dichotomy in original sin economies. The NBSA analyses intend to supply that mechanism by shifting attention from the current account (flows) to the capital account (gross stocks).

Economists have applied two different flavors of the argument to developed countries. Obstfeld's (2012) argument that the capital account now matters more than the current is general, though clearly motivated by the euro-zone crisis. He observes that large scale credit creation, which in turn drives large scale cross border flows, is empirically connected to subsequent financial crises. In contrast, Gourinchas, Rey and Truempler (GRT) (2012) make the strongest argument that the capital account and balance sheet matter even for the United States, because of what they term the 'insurance' function the US provides in global capital markets.

Large scale credit creation obviously increases the probability of some kind of mismatch, currency or otherwise. Moreover the empirical connection with subsequent crises suggests a typical 'minsky' dynamic in which successive waves of borrowers generate a bubble by taking on more and more debt and risk in pursuit of narrower and narrower capital gains (Minsky, 1977). For Obstfeld, large scale gross positions create risks much larger than those generated by current account flows. The trust in private wisdom inherent in the Lawson and Pitchford doctrines holds no water (let alone the Lucas model in which countries hold symmetrical portfolios). Public officials cannot assume that private actors' investments will automatically net out all risks aside from those generated by errant fiscal policy. NBSA accounts focus on the danger that these large international positions can change wildly every day based on exchange rate swings, rather than Minsky-type risks. Swings create the possibility that some private actors might find themselves illiquid or insolvent. If this poses a systemic risk, then the public sector will have to intervene, potentially damaging its own balance sheet.

The Eurozone crisis stemmed from maturity and, to a lesser extent, currency mismatches rather than the exchange rate shifts that NBSA worries about (Obstfeld, 2012, pp. 16, 20–21). There, private, mostly northern European banks accumulated large gross positions on both sides of the Atlantic. In principle these positions looked balanced in currency terms, with dollar liabilities matched to dollar assets in the west, and euro liabilities matched to euro assets in the south. In practice, both sets of claims contained maturity mismatches. A collapse in dollar asset values left northern European banks with unmatched dollar liabilities, triggering a withdrawal of liquid northern European bank lending to southern European banks. In turn, this confronted those southern banks with demands to satisfy euro liabilities but no way to easily liquidate their relatively long-term euro denominated housing assets. Many European banks thus found themselves insolvent. From Obstfeld's point of view, both creditor and debtor countries here were exposed to risks flowing from outsized balance sheets that in the aggregate looked matched but internally contained a variety of mismatches.

But these problems are not intrinsically international: They could apply to any common banking crisis, they are largely theoretical, and they don't seem to apply to the United States. The European situation differed from the US situation in two

and a half critical respects. First, unlike the pre-Mario Draghi ‘anything it takes’ ECB, the FED was willing and able to supply money to cover bank losses arising from the inability to roll over liabilities. Second – but this is the half – most of the time US bank exposure to foreign currency risks is much smaller than European banks’ exposure. Finally, massive mismatches between assets (mostly equities and in foreign currency) and liabilities (mostly fixed income and in dollars) do characterize the US international investment position. The first two seem to mitigate worries. But the last raises genuine concern in NBSA. Here GRT (2012) try to measure the scale and distribution of gains and losses on various aggregate national balance sheets during the 2008 crisis.

GRT aggregate portfolio, equity and direct investment data for the major economies in order to assess who gained and who lost wealth from the global financial crisis, and equally important to suggest a mechanism allocating risk across balance sheets. In particular they drill down into losses from the toxic instruments at the heart of the crisis. They confirm two of Obstfeld’s stylized facts about the global financial system, namely the emergence of huge cross-border investment stocks and, relatedly, huge imbalances in current account surpluses and deficits among the major economies. The US currency and instrument mismatch particularly stands out. Like Despres, Kindleberger, and Salant (1966), GRT interpret this mismatch as the United States providing a kind of aggregated banking service to the world. Despres et al. argued in the 1960s that the United States provided maturity transformation for the global banking system by holding short term deposits from the rest of the world and lending back long term.

GRT argue that the United States has expanded this role to encompass a form of insurance for the entire range of financial products, providing safe assets to the world while investing in riskier assets globally. Thus, the US balance sheet disproportionately holds direct investment and portfolio equity assets, while its liabilities comprise mostly fixed debt instruments and particularly government and government guaranteed bonds (Schwartz, 2009). GRT assess the insurance function by looking at the distribution of ‘losses’ in the 2008 crisis. The United States accounted for 69% of notional losses and thus ‘insurance’ in 2009.

GRT claim this asymmetry specifically exposes the US international balance sheet to considerable and growing foreign exchange rate and credit risk. The credit risk is obvious and consistent with Obstfeld’s argument: riskier assets are more likely to default, and in GRT’s world US entities in aggregate provide safe assets while buying relatively riskier ones.² But GRT focus on currency mismatch rather than Obstfeld’s maturity mismatch. GRT counterintuitively argue that the United States faces precisely the opposite problem from the usual currency mismatch problem facing original sin countries. US foreign exchange rate risk comes not from the risk of its own currency, the dollar, weakening, as with original sin developing countries, but rather from dollar appreciation. A stronger dollar devalues US-held overseas assets that are denominated in non-dollar currencies; symmetrically a weaker dollar revalues those assets. While a disproportionate share of global lending is done in dollars (stat.BIS.org), roughly two-thirds of US overseas assets are equities and direct investment and thus foreign currency denominated. A stronger dollar thus worsens the US NIIP by increasing the value of dollar-denominated foreign claims on the United States while reducing the dollar value of foreign currency-denominated US assets.

GRT calculate that the direct and exchange rate driven losses from the global financial crisis and subsequent rapid dollar appreciation caused a \$2.2 trillion loss on the US global balance sheet. GRT see this as a wealth transfer, in the form of insurance, to the rest of the world. They neither explore the political implications of this wealth transfer nor make policy recommendations. But they do claim first, that these large balance sheet positions mean that even countries with apparently balanced positions and no current account deficit are vulnerable to exchange rate swings, and second, that this problem also inheres to the United States, despite its possession of the global key currency. Thus, for GRT, changes in the gross stock of investment now overshadow the trade and hot money flows previously seen as triggers of financial crises. This is true numerically, but for it to be substantively true requires a mechanism affecting the macro-economy. Hardie and Maxfield (2016) try to supply this mechanism.

Hardie and Maxfield (H&M) (2016) argue that GRT's findings imply considerably reduced autonomy and thus international monetary power for the United States. H&M accept and amend Benjamin Cohen's (2006, 2012; Andrews, 2006) arguments that the essence of international monetary power is policy autonomy. Autonomy is the ability to delay adjusting to current account imbalances, and thus the ability to shift costs on other actors, particularly creditors. But H&M (2016, p. 585) see Cohen's focus on the current account as too narrow, given that 'the magnitude of countries' external balance sheets increasingly challenges the centrality of current account deficits in the analysis of US international monetary power.' Like Obstfeld and GRT, H&M argue that the large stock of international assets implies that the capital account and gross investment positions themselves overshadow trade and income flows. Furthermore, this means that dispersed private actors now restrict US policy autonomy.

H&M argue that private financial markets increasingly determine the value of those international investment stocks, because exchange rate changes, asset composition, and differential returns to assets all derive from decisions by private actors in financial markets. Moreover, 'even more significant is the fact that private financial market actors' decisions result in wealth transfers which change US differential economic growth, regardless of the overall market willingness to finance the US deficit. In other words, private financial market actors' strategies for their relative investment into the United States and elsewhere constrain US autonomy and international monetary power' (H&M, 2016, pp. 597–598).

This argument makes differential growth (Nitzan & Bichler, 2009; Schwartz, 2009) a dependent variable of changes in asset positions. Virtually all the action in H&M occurs through wealth effects subsequent to a rising or falling dollar value for US international assets. '[J]ust as flows into the US will always have a positive impact on economic growth, wealth transfers from the US will always have a negative impact' (H&M, 2016, p. 598).³ A falling dollar exchange rate or other changes that increase the value of US overseas assets relative to its liabilities have a strongly positive effect on the US economy. In contrast, a stronger dollar or other changes that decrease the value of US overseas assets relative to its liabilities have a strongly negative effect, because they transfer wealth away from the United States.

Furthermore, H&M (2016, pp. 601–605) also argue that quite aside from this diminution of US passive monetary power, the large stock of overseas assets characterizing most economies sharply limits the autonomy of the Federal Reserve

Bank (FED). H&M argue that the FED has lost its ability to discriminate between US and foreign financial firms, and among foreign financial firms in the 2009 crisis. In order to save the US financial system, the FED had to bail out virtually every foreign banking system as well. This loss of discrimination shows that the US has lost active global monetary power.

To sum up: We can discern three different and, with respect to US global economic power, increasingly specific balance sheet based arguments. Obstfeld identifies large, potentially non-netting gross financial positions as a source of generic currency, maturity and credit risk mismatch, but these threaten all countries and in the case of rich countries massively overshadow exchange rate risks. GRT identify the specific currency and asset-type (risk) mismatch between the United States and the rest of the world related to the insurance function. H&M narrow this mechanism further, arguing that even in non-crisis times, exchange rate shifts affect US policy autonomy with respect to macro-economic policy and that in crisis times the FED is constrained to bail out foreign banks.

Flows versus stocks, and which flows?

In slightly different ways all three claims share the same strengths and weaknesses. They identify a new phenomenon or *explanandum* in the form of substantial global investment cross-holdings. These large positions surely matter, but how much and why? The NBSA thus open the door to rectifying older economic textbook views on global investment the same way that investigations into intra-industry trade and global commodity chains rectified older economic textbook views of trade. Those older trade models assumed that otherwise isolated countries exchanged more or less fully built up commodities; the older investment models assumed that capital flowed downhill from rich to poor countries bilaterally and that nationality of ownership reflected residence of ownership. Yet all three claims implicitly rest on the assumptions of the older textbook models, despite their concern with investment positions across rich countries and the expansion of complicated flows producing huge grossed up positions. Two problems from the older model stand out.

First, rather than bilateral lending from capital rich to capital short societies, we now live in a world in which a subsidiary of a bank headquartered in country A, but located in country B, might borrow funds from institutions in country C for on-lending to the subsidiary of a firm headquartered in country D but operating in country E. As Shin (2017) puts it, we live in a matrix world (i.e. rows and columns, not the eponymous movie) rather than a world of islands connected only through strictly bilateral flows. However, this calls into question the meaning of the national balance sheets used by all three arguments above. In the example above, the national investment data would show an asset for country C and a liability for country E, while the actual risks (or benefits) fall on firms in countries A and D. This is why the BIS now reports data on bank balance sheets by both residence (where the lending subsidiary is physically located) and nationality (where ownership of that firm is legally located).

Second, rather than investment flowing downhill on a net basis, much capital flows uphill, and in particular into the US economy. Chinese and Japanese net lending to the United States is obviously problematic for the older model of capital flows, particularly as it largely takes the form of fixed income securities and within

that, low yielding Treasuries. Equally so, with few exceptions, the richer European economies all have per capita GDP lower than that of the United States in both nominal and PPP-adjusted exchange rate terms. Have these countries really exhausted all domestic investment opportunities, particularly given that US firms and equity investors find it profitable to invest in those same rich economies (again, Japan a partial exception)? Are US investors in the aggregate really more risk accepting than European investors?

So while these three arguments correctly draw attention to the issue of large global investment cross-holdings, they remain somewhat trapped in a Bretton Woods mentality, in which semi-closed national economies exchange fully built-up goods and invest bilaterally. This produces the usual fallacy via analogy to household debt. It also directs attention to the exchange rate as the determinant of trade flows, rather than to growth rates as the determinant of import demand and to corporate strategies around global commodity chains as the determinant of fixed investment. In addition, looking at aggregate asset/liability data ignores the actual mechanical sources of rising US external debt, which are susceptible to policy interventions. Finally, it leads all three to see the persistent current account deficits driving rising US net international debt as a bug rather than a feature of the current global economy.

States free from original sin are not households. Typically, the inability to issue debt internationally (or, worse yet, domestically) in one's own currency is a problem of states that are doubly weak. They are weak in Michael Mann's (1984) sense of weak: lacking enough infrastructural power to compel their subjects to pay (enough) taxes on a routine basis to be able to service their debts. Here we can usefully note that the US net foreign debt of roughly \$7.6Tr in June 2017 approximated the pool of externally held US government and government guaranteed debt at \$6.4Tr. This represents a massive global bet – roughly 9.0% of global GDP – on the US state's capacity to tax its economy.

Weak states are also economically weak: unable to produce and export goods and services in sufficient volume and price terms to offset their own need or desire for imported goods and services. Weakness produces both currency and credit risk. Lenders to original sin countries offset currency risk by lending in saintly currencies. Typically this means the US dollar, which accounted for a consistent 50–60% of cross-border lending over the past 15 years, and more if intra-EU lending is netted out. Lenders limit credit risk by demanding high interest rates even for short term loans to weaker economies. But the states and economies that generate the bulk of assets (and thus liabilities) on global balance sheets do not suffer from original sin. In particular, the United States has only trivial amounts of private and public foreign currency liabilities. For example, as of 2q2018, only 16.3% and 3.1% of US financial firms' cross-border liabilities were denominated in euro and yen, respectively. In contrast, 35.8% of cross-border liabilities for financial firms in eight major European economies were dollar denominated.⁴

Original sin and its sources in state weakness matter for understanding any negative effects from the asset positions described above. Put simply, the United States, for the foreseeable future, cannot suffer a 'sudden stop' currency crisis akin to the 1994 Tequila (Mexico) crisis or the 1997 Asian Financial Crisis. In those crises, countries suffering from varying degrees of original sin found themselves short of foreign currency to make good on external foreign currency liabilities. But the

2008 financial crisis showed that the FED and thus the US government can print as many dollars as it needs. The FED more than doubled the M1 (cash) money supply from \$1.4T in July 2008 to roughly \$3.4T in April 2017, and M2 (cash plus repos and money markets) from \$7.7T to \$13.4T in order to cope with the global financial crisis. This is rather larger than the whole of the \$2.2T in losses GRT identify. Indeed, GRT's 'insurance function' is better understood as the FED playing a lender of last resort role for a dollar-based global financial system.

Nor can the United States suffer a 1992 European Exchange Mechanism-style crisis, because it has not pledged to defend a particular exchange rate against other currencies. Paradoxically, if H&M are correct, the valuation changes associated with a weakening dollar in a currency crisis would produce positive wealth effects in the United States, boosting aggregate demand and growth. Equally, a much weaker dollar makes much US external net debt 'disappear' as well, by enabling some notional aggregate US actor to exchange appreciating foreign currency assets for its depreciated US dollar liabilities.

The United States is thus not like a household facing a hard budget constraint imposed by external creditors. Crises like Britain's 1960s sterling attacks or Korea's 1997 catastrophe are unlikely. Britain's problem, ultimately, was that it exported nothing anyone wanted. Seventy percent of its exports in the 1960s were in the vulnerable coal, iron, steel and textile sectors, and it ran current account deficits almost continuously from 1950 to 1966 (Strange, 1971, p. 315). Korea's problem, ultimately, was original sin, with short term foreign currency liabilities four times the size of its foreign currency reserves. The United States still makes things people want, and borrows in dollars. And this is before considering that a substantial part of the US current account deficit and thus nominal foreign liabilities are derived from and owned by US MNCs parking profits in off-shore tax havens and thus not strictly speaking true foreign claims on the US economy. Brad Setser (2018) estimates that tax avoidance accounts for roughly 1 percentage point of GDP in the US current account deficit, which is more or less a quarter to a third of the annual deficit; the Center for Tax Justice (McIntyre, Phillips, & Phineas Baxandall, 2015) estimates that US firms have roughly \$2.1T parked offshore, which is also roughly one-quarter of the US net foreign debt.

Finally, and this is the critical point, all of these dangers stem from a loss of confidence about the underlying profit and wage/income flows that validate equity and bond values. US assets are 'safe assets' only to the extent that people believe they are safe, and this belief stems from and ultimately is validated by those underlying flows. Legally an 'asset' is only a claim on those flows. This becomes clear once we seek a mechanism for translating exchange rate driven changes in gross asset positions into some significant macro-economic effect; the next section does this. But put simply, the exchange rate shifts because of changes in beliefs about income and profits; income and profit flows (and thus the assets they validate) do not shift because of changes in beliefs about exchange rates. Moreover, in the NBSA account, a weaker exchange rate – which normally signals some disbelief in long-run US economic potential – strengthens the US balance sheet and thus indicates stronger long-run US economic potential. It is possible to foresee a future in which a widespread loss of confidence in the underlying productive (and military) power of the US economy leads actors to refuse payment in dollars or dollar-denominated assets. Then, as Hemingway put it, after going bankrupt gradually

(the perpetual current account deficit) the United States might go bankrupt suddenly (a currency crisis). In that scenario, the wealth effects NBSA predicts help the US economy, but this kind of scenario reflects problems much, much larger than what NBSA fears.

Wealth effects

Obstfeld worries about generic instabilities in financial markets. The kinds of problems that trouble H&M and GRT are counterintuitive, because they emerge when the dollar strengthens, not weakens. But it's hard to find a plausible mechanism for this counterintuitive assertion, as normal trade and investment flows still dwarf the wealth effects both arguments posit. Wealth effects occur from an exogenous increase in household wealth. Households typically treat this wealth as a windfall, and spend part of it, either directly by cashing it out, or indirectly by decreasing saving from their current income. Wealth effects are real but with smaller effects than GRT and H&M posit. The wealth effect argument has five problems. First, the currency risk embodied in the US global balance sheet is smaller than an abstract assessment suggests. Second, exchange rate shifts don't actually transfer wealth. A rising US dollar does not, e.g. move anything from the United States to its suddenly wealthier creditors until those creditors exercise that claim by buying US goods or services. Third, even if we ignore the implications of the uneven distribution of wealth, the scale of the wealth effects discussed by GRT and H&M are not that significant, particularly when compared with normal flows and asset booms. Fourth, the distributional issues are non-trivial and limit wealth effects; most assets are held by firms, the 1%, and, crucially, as relatively illiquid pension funds by the top 20% of the income distribution in a narrow slice of countries. Fifth, currency fluctuations have contradictory effects: while a stronger dollar diminishes US net national wealth, it enables US firms to expand overseas more easily and cheapens imports, thus potentially offsetting any negative wealth effect on consumption.

First, the NBSA arguments assume that the US is foreign currency long on the asset side while US dollar long on the liability side. The latter is true. But the former is not completely true. In 1997 (the earliest data), 60%, and from 2004 forward, roughly 75% of US holdings of foreign debt securities have been US dollar denominated (US Treasury, v.d.). Added to dollar-denominated loans, this means that roughly 20% of US overseas assets are dollar denominated. This mitigates the currency mismatch at the heart of the NBSA arguments.

Second, a stronger dollar notionally makes dollar long creditors wealthier on an aggregate national basis, but it also leads them to purchase expensive US assets. A stronger dollar makes non-dollar denominated goods cheaper, with the unsurprising effect of worsening the US trade deficit at the margin. The counterpart to this deficit is a US capital account surplus as foreigners fund the US current account deficit by buying US assets at strong-dollar prices. In contrast, periods of dollar weakness correlate with shrinking US current account deficits and slowing domestic investment, precisely the opposite of what the NBSA predict. Historically German, Japanese and Chinese growth has been substantially export driven. While the United States has accounted for 51% of global current account deficits 1992–2017, these three accounted for 43.3% of global surpluses, or 91% of the US

deficit (see Table 1). Moreover, net exports account for roughly 25–30% of Japanese and German GDP growth from 2005 to 2017 (OECD, 2017). The benefits of a strong dollar to foreign creditors flow from increased exports and growth rather than notional wealth effects.

Third, the purported wealth effects are relatively insignificant. While US overseas wealth is large, domestic wealth is even larger. US households and non-profits had net worth of about \$103 trillion at the end of 2017, about three times gross foreign claims and twelve times net foreign debt (Federal Reserve Bank, Flow of Funds, Z.1, line 34). On the credit creation side, Hume and Sentance (2009, p. 1440) note that domestically generated credit, 1998–2007, was five times net foreign inflows. Thus domestic financial shocks will almost always matter more than exchange rate driven ones.

The dollar depreciated roughly 32% peak to trough, mid-2001 to -2008 provoking a new round of negative assessments of the dollar's durability (Bergsten & Williamson, 2004; Helleiner & Kirshner, 2012). From NBSA's point of view, this should have produced massive currency derived-wealth effects. But the vast majority of wealth effects those years came from Americans cashing out their increased home equity via massive domestic credit creation and lax regulation. The international connection was about flows, not stocks. Rising current account deficits had as their natural counterpart capital account surpluses (i.e. investment inflows). These manifested as foreign purchases of US Treasuries and mortgage bonds, and thus enabled part of home equity cash out. The rest came from European banks intermediating US savings back into US mortgages.

On the other side, the Global Financial Crisis generated large negative wealth effects in the US economy. As GRT (2010, p. 11) note, US investors and homeowners had financial losses of almost \$17 trillion, 2007–2009. But this had little to do with exchange rate shifts. Similarly, any future meltdown of US equity markets, for example, is likely to have more profound causes and consequences than simple shifts in exchange rates. But the compositional effects of cross-border holdings limit the wealth effects at the heart of the GRT and H&M mechanism. Most cross-

Table 1. Cumulative current account deficits (surpluses) 1992–2017, \$billion and % of total.

Deficit countries			Surplus countries		
	\$ bil.	%		\$ bil.	%
United States	-10228.3	50.6%	Japan	3381.7	15.1%
United Kingdom	-1798.0	8.9%	China	3300.8	14.7%
Australia	-868.8	4.3%	Germany	3023.9	13.5%
Spain	-834.2	4.1%	Gulf Oil exporters ^a	2437.4	10.9%
Brazil	-699.5	3.5%	Switzerland	1117.5	5.0%
Turkey	-566.1	2.8%	Russia	1115.0	5.0%
India	-478.5	2.4%	Netherlands	1084.8	4.8%
Mexico	-422.2	2.1%	Singapore	799.2	3.6%
Canada	-416.1	2.1%	Norway	796.1	3.6%
Greece	-369.0	1.8%	Taiwan	745.9	3.3%
Poland	-273.7	1.4%	Korea	684.7	3.1%
Portugal	-259.4	1.3%	Sweden	489.8	2.2%
<i>Sum, these 12</i>	<i>-17,213.7</i>	<i>85.2%</i>	<i>Sum, these 12</i>	<i>18,976.9</i>	<i>84.7%</i>
Global deficits, total	-20,207.2		Global surpluses total	22,398.2	

^aSaudi Arabia, Kuwait, Qatar, UAE.

Memo: Japan, China and Germany as % of US deficit: 91%.

Source: IMF, WEO database.

border asset holdings appear to be equities, bonds and FDI. (Appear to be, because some portion of cross-border financial assets are actually disguised holdings of real estate, as when, e.g. a Luxembourg shell company owns all the equity of a US company whose only asset is a piece of US real estate [see Palan, Murphy, & Chavagneux, 2013]). In contrast, real estate looms large in domestic wealth (and most lost US wealth 2008–2010). Globally, an upper bound estimate is that real estate comprised 34% of total liquid assets and 58% of total liquid and illiquid assets in 2015, with residential real estate comprising 22 and 44% respectively (Savills World Research, 2016; Credit Suisse, 2017). A lower bound estimate puts all real estate at 22% of liquid assets and 43% of total assets. Both estimates are conservative in that most securitized debt is collateralized against real estate.

The distinction between financial and housing assets matters because most studies identify larger wealth effects from housing wealth as compared with financial wealth. For example, the classic Case, Quigley, and Shiller (2005) study found strong wealth effects from US housing at about 3 cents per dollar of new wealth (3%), but that purely financial assets had no statistically significant wealth effects; for European housing markets they found an implausible 11% increase (implausible because of the illiquidity of most European mortgage markets [Delfani, De Deken, & Dewilde, 2014]). More recent ECB research (Carroll et al., 2010; Paiella & Pistaferri, 2017; Sousa, 2009) has slightly conflicting findings, but overall finds larger wealth effects for both financial and housing assets than Case et al. (2005). Sousa (2009) estimates that the marginal propensity to consume out of financial assets in the Eurozone is 0.7 to 1.9% of the net increase. In contrast, Carroll et al. (2010) estimate an immediate 2 cents increase in consumption per dollar of extra housing wealth in the United States, with a cumulative effect of up to 9% or 9 cents per dollar. However, all of this research tends to ignore or underestimate the relative illiquidity of most European mortgage and housing markets, and equally so is out of date in the post-crisis US banking environment, where cash out of home equity is now considerably more difficult and only turned positive on a net basis at the end of 2017.

But for the sake of argument, let's very generously assume that the typical household will spend 5% of an exogenous increase in asset values. At 5%, the \$2.2 trillion 'loss' GRT identify for the United States in 2007–2008 would produce a negative wealth effect of roughly \$110 billion. This is only 0.76% of recession-diminished US 2009 GDP. And this crisis-event 'loss' pales compared with other normal-economy big numbers that we know had significant macro-economic effects. For example, the cumulative increase in US housing prices from roughly 2001 to 2007 was \$8 trillion. With a 5% wealth effect this should produce a \$400 billion increase in spending; in fact, mortgage equity withdrawal (net of debt repayment) in the United States averaged \$376 billion annually from 1991 to 2005, peaking at over \$756 billion in 2005 (Greenspan and Kennedy, 2008, pp. 128–129). Similarly, the US current account deficit – a normal, non-crisis flow – was also roughly \$380 billion per year, 1992–2017, or three times GRT's notional, once only, and probably overestimated wealth effect. Or contrast the \$2.1 trillion held offshore by US Fortune 500 companies; CTJ (2015) estimates that these holdings allow firms to avoid \$90 billion in taxes each year. Even if US wealth holders felt the whole \$110 billion wealth effect from the 2008 crisis, it would have smaller

effects than any of the normal year-to-year effects of the US housing market equity withdrawal, the current account deficit, or US corporate tax avoidance.

Finally, Keynes' animal spirits also matter. The FED's quantitative easing and other emergency liquidity measures boosted notional US wealth 2013–2014 by the same \$8 trillion that housing equity increased, 2001–2007; US wealth increased another \$8.5 trillion 2016–2017 (Credit Suisse Research Institute, 2017). Yet the overall macro-economic effects were nothing like that of the earlier gain, because consumer and investor psychology had changed. Put bluntly, a generous estimate of the hypothetical NBSA wealth effects from the worst financial crisis in 80 years are at best equal to and more often less than the effects of a variety of normal flows.

Fourth, distributional effects reinforce these compositional effects from nominal changes in wealth. Foreign holdings in both directions are largely composed of equities and bonds, and those assets have weaker wealth effects than changes in housing prices. Housing is a broadly held asset, which makes house prices wealth effects stronger than financial asset changes. All wealth is unequally held, but financial assets even more so. The most recent US Survey of Consumer Finances (Federal Reserve Bank, 2016, tables 6 13 means, 9 13 means) shows that the top 10% of households by net worth held 30% of the total value of residential property, but 63% of financial assets in 2013; the Gini index for US wealth is .859 (Credit Suisse Research Institute, 2017, p. 115). Families in the top 10% by wealth had mean income over \$400,000. Rising home equity wealth might motivate more spending in the cash constrained bottom 90% of the population, where housing constitutes the bulk of wealth. But it's harder to see how wealth effects from changes in financial assets might motivate more spending from the top 10%, let alone the top 1%, whose marginal propensity to consume is low. Meanwhile, the bottom 99% largely hold financial assets as relatively illiquid pension assets. Pension assets account for roughly half of US financial assets (Credit Suisse Research Institute, 2017, p. 142); globally they account for 34% of institutionally managed funds.

Finally, GRT and H&M frame US geo-economic power simply as autonomy or insulation from externally caused adjustment, reflecting a Bretton Woods-era fixation with trade deficits under a system of fixed exchange rates and nominal gold backing for fiat currency. In that frame, the negative balance sheet and wealth effects of a rising dollar loom large. But the assets and liabilities on balance sheets are secondary to the income flows that establish those values. A stronger dollar exchange rate – the 'bad scenario' for wealth effects and wealth losses from GRT's and H&M's point of view – means that the relative weight of the US economy and US firms rises in world markets. On average, US transnational firms get a larger proportion of their revenues in dollars than firms from other countries, and also get a larger proportion of their revenues from the US domestic market. In 2016, for example, US firms in the UNCTAD defined 100 largest non-financial multinational enterprises only had 48% of sales revenue from non-domestic sales, versus a weighted average of 72% for non-US firms (UNCTAD, 2016, annex table 24). A stronger dollar would increase US transnationals' and would-be transnationals' ability to expand their control over global production via external acquisitions. A 'weaker' US national balance sheet corresponds to a stronger position for actual US firms.

Power and plenty once more, in relation to growth

Two related problems drive misapprehension in the NBSA analyses. The first problem stems from the fact that asset values are rather more a dependent than independent variable. Put simply, changes in asset prices do not change income streams, but real and anticipated changes in income streams do drive asset prices. Asset values reflect the aggregation of varying investor expectations about the likelihood that a given stream of income will continue, referenced against an apparently guaranteed stream of income from the government debt of stable states. Investors' rational and irrational beliefs shape expectations about whether measured past performance will continue (Harmes, 1998; Nitzan & Bichler, 2009; Palan, 2015). In this sense, asset prices are one manifestation of underlying power dynamics producing those income flows. Those dynamics are the degree to which ordinary people comply in a routinized, self-motivated fashion with the goals elites set, producing goods and services and making payments on their liabilities. This is the essence of what Michael Mann (1986), has called infrastructural power, in his updating and expansion of Weber's (1978) idea of caging (see also Bourdieu, 1977, 2014; Foucault, 1977; Nitzan & Bichler, 2009).

Balance sheets make this relationship clear. Every financial asset on a balance sheet necessarily has a counterpart liability. The income streams from debts, rents or corporate surpluses give assets their market value; assets do not call income streams into being. Debt service implies individual compliance with behaviors producing some marketable product or service whose sale generates the cash for loan, bond, and dividend payments. Asset values ultimately are derived from beliefs about future compliance with that process. Those investor beliefs are central to the exchange rate and investment changes in the NBSA analysis. Indeed, H&M are quite explicit about this, identifying private investor sentiments as one major constraint on the American Atlas, even though in pointing towards income (flows) rather than assets (stocks) as the critical issue they undercut their analysis.

This points to the contradiction in the NBSA analyses. In these analyses, bad outcomes flow from a strengthening US dollar; yet the dollar only strengthens to the extent that investors hold sanguine expectations about the US economy, or are dependent on US deficits for their own growth (Raico, 2018). Dollar depreciation, which has positive effects for the US balance sheet and negative ones for foreign investors in the United States, typically occurs when public and private investors are unwilling to lend to US entities, to buy US assets, and to accept US dollar-denominated assets from non-US entities. The low points for the dollar were precisely the times when external (and internal) confidence in the US economy was at its lowest: 1978, when inflation shot past its prior peak and German firms seemed dominant; the early 1990s before the Clinton/internet boom when US growth looked slower than Japanese growth and Japanese firms likewise looked like world conquerors; and 2004–2008 when the US current account deficit hit the seemingly unsustainable level of roughly 5.2% per year on average for more than five years and China averaged 11.6% real GDP growth per year. Or put bluntly, investor sentiment and expectations affect assets values (via the price they paid for the last equity, bond, or house), but asset values do not affect investor sentiment except to the extent that people hold Keynesian beauty contests and try to assess what other investor's sentiments and expectations are.

And yet, all this points to a perplexing problem behind the large positions NBSA highlight in the aggregated US international balance sheet. The United States has run nearly continuous trade deficits from 1980 to 2017, averaging 2.5% of GDP and cumulating to \$11 trillion in current dollars. In the Bretton Woods era, a current account deficit of \$2 billion (\$11.9 billion in 2017 dollars) that was less than 1% of GDP was sufficient to motivate Nixon to shut the gold window even though the US NIIP was strongly positive. Yet today's current account deficits – at \$449 billion in 2017 nearly 38 times as large as the 1972 deficit in real terms – and negative NIIP of 40% of GDP raise far fewer alarms. Moreover, the US balance sheet seems impossible to understand: the cumulative current account deficit should have as its counterpart a negative US NIIP substantially larger than the one the balance sheet currently shows (H&M, 2016). The gap at the end of 2017 was a non-trivial \$3.3 trillion, counting forward from 1980. Norrlof (2010) attributes the gap to unrealized capital gains, Setser (2018) to profits held offshore, but this only pushes the issue one step forward. Those gains necessarily must relate to an expectation of future income streams, and this in turn is the essence of the still unexplained 'dark matter' that Hausmann and Sturzenegger (2007) attributed to better management, and therefore implicitly higher profits by US transnational firms. Yet the existence of dark matter also has both micro-economic and macro-economic implications that more clearly suggest the sources and vulnerabilities of US geo-economic power than do exchange rate driven wealth effects.

The arguments in Schwartz (2009) and Norrlof (2010, 2014) about the sources of global growth ultimately resolve into a simple matter of GDP accounting. In conventional GDP accounting growth is the sum of the change in *Consumption* (which includes government transfers), *Government* spending net of transfers, *Investment*, and *Net Exports*; $GDP = C + G + I + (X - M)$. So on first glance, a current account deficit implies a subtraction from GDP. Yet as Figure 1 shows, aside from Canada, the US has continually outgrown the rest of the G7 in the post-Cold War era. And by a large amount: 31.5 percentage points versus Germany and 45.1 percentage points versus Japan. From 1992 to 2017, the compound annual real GDP growth rate in *local currency* for the United States was 2.52% versus 1.4% for Germany, 0.91% for Japan, 2.16% for the ever-enlarging OECD and, for reference, 1.47% for the Eurozone (IMF, 2018). (Local currency data strip out currency fluctuations.) Demographics explain part of the difference, but demography is sensitive to growth rates as people judge the costs of an additional child. Per capita annual GDP growth figures over this period respectively are US 1.55%, Germany 1.29% and Japan 0.84%. In 2017 Germany and the EU as a whole grew slightly faster than the United States on the back of a €250 billion current account surplus, of which a bit over 60% was with the United States, but the usual pattern returned in 2018.

This inversion – trade surplus economies growing more slowly and trade deficit countries more quickly – is unusual for developed economies. It implies that the underlying growth rates in the anglo-economies are higher, and in the big export surplus countries lower, than the final, post-trade growth rates. Faster growth for the United States, in particular, usually implies larger current account deficits and by definition more foreign capital inflows and thus higher US net foreign debt.

This is somewhat the opposite of what H&M (2016 p. 588) argue when they state that 'increased US indebtedness as a result of valuation changes on the

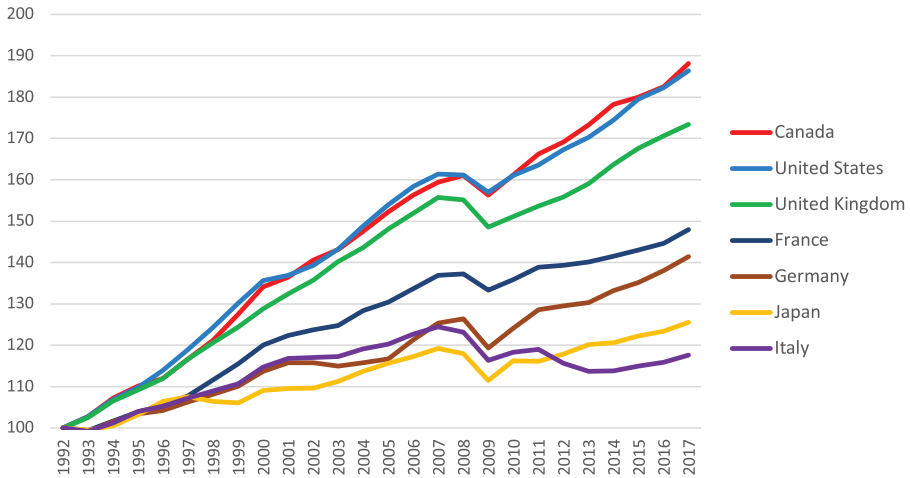


Figure 1. G7 GDP growth in real local currency terms, 1992–2017 index, 1992 = 100. Source: IMF WEO database.

external balance sheet, in contrast, reduces near-term US growth.’ Rather, faster US growth leads to deficits that by definition are accompanied by rising foreign debt. Faster US growth generally covaries with a stronger dollar rather than the NBSA prediction of wealth losses that instead somehow translate into slower growth.

Here too a paradox emerges: foreign investment in the United States implies a belief in larger future income streams from claims on US production, and thus higher asset values for those claims. And again, as domestically based wealth is larger than international holdings, we would expect that the positive wealth effects would outweigh the negative ones. In all this, though, it is growth that generates income, and (past and expected) income flows (along with animal spirits) that drive asset prices. Wealth is a claim on income streams. But income streams come first, then wealth. And growth is what creates sustainable income streams and thus wealth. In this respect, the US current account deficit is a feature, not a bug, in the global economy. In a demand short world – as evidenced by sluggish German/Eurozone and Japanese growth despite massive export surpluses, decelerating growth and investment rates relative to the 1980s, low inflation, mediocre wage growth, and continued weak eurozone employment – the US deficit is what supplies both demand and wealth (in the form of US dollar assets) to the rest of the world. As noted above, average US current account deficits of 0.79% of global GDP per year provide a non-trivial stimulus for export dependent economies in Europe and Asia. Although China’s reliance on exports for growth has been declining and indeed China is trending towards a balanced current account, its persistent current account surpluses have subtracted from growth elsewhere.

This demand creation is ultimately a major component of US geo-economic power, though the growing importance of Chinese and more generally emerging market demand is clearly eroding that power, just as the Republican administration after 2016 and the earlier global financial crisis undermined belief in US financial practices and stability (Kirshner, 2014). The material case around demand creation is simple and rests on Hirschman’s (1942; see also Prasad, 2015) original analysis

about asymmetrical dependence. Put simply, since 1992 the United States accounts for 51% of the cumulative aggregated global current account deficits, while Japan, Germany and China account for 43% of cumulative surpluses (IMF, 2018). Table 1 provides more comprehensive information. Roughly speaking, net exports contributed about one-third of German and Japanese growth from 1992 to 2017, while subtracting about one quarter of US growth (OECD, 2017). These current account surpluses are typically associated with a stronger US dollar, which implies that exporters acquire the counterpart US assets at relatively high prices generated by that strong US dollar and the high equity valuations that typically accompany dollar strength.

What does it profit a Mann ...

The external balance sheet is an important determinant of national economic power and a source of risk. But NBSA exaggerate that importance when it comes to US geo-economic power. Exchange rate and other sources of valuation change do affect a country's 'net worth.' But in general this tells us very little about macro-economic effects or power, and with specific reference to the United States, it misstates the nature of US power. Put simply, exchange rate driven changes in the external balance sheet can be devastating for countries suffering from original sin and carrying large hard currency liabilities. For the United States, they are at most an inconvenience. Both are the tail on the dog. The asset (and liability) values on external balance sheets are for the most part dependent variables. Changes in asset values do have an independent effect via the wealth effect channel. But asset values are a function of projected income and profit streams. Increased pessimism about those income streams has a far greater effect on the economy than the wealth effects from exchange rate shifts, and exchange rate shifts matter most when a country cannot issue liabilities in its own currency. Likewise, the complicated web of grossed up financial claims can conceal massive systemic risks. But in either case, the balance sheet is a dependent variable.

Systemic risks flow from the dynamics that Minsky (1977) elaborated. Those risks come from a lack of income to service liabilities. Original sin countries cannot autonomously generate that income. But the United States can generate dollars to service its external public sector liabilities and bail out its financial system. Could creditors refuse those dollars? A sudden stop-style crisis for the dollar would imply that the majority of trade surplus countries suddenly switched to balanced trade with the United States. This would surely depress the dollar's exchange rate, wrecking balance sheets and growth in trade surplus countries. Much of the dollar's durability rests on trade surplus countries' unwillingness to self-inflict these wounds or to shift their political economies in the direction of greater domestic demand. *Vide* the German obsession 2014–2018 with maintaining the *schwarze Null* – 'black zero' – in their fiscal balance. The same logic holds for marginal shifts away from the dollar; the reductions in the US current account deficit subsequent to a weaker dollar would produce faster US growth, all other things being equal.

All that said, focusing on external balance sheets is important because it re-opens the question of why, precisely, the cumulative US current account deficit does not match the US NIIP, why, precisely, US firms have such relatively high profits, and why, precisely, the US is able to run continual current account deficits.

The external balance sheet thus points to several important yet massively under-researched areas in IPE. First, even if they are accurate – which Linsi and Mügge (2017) call into question – aggregated national balance sheets don't actually tell us who owns what. Tax havens and complicated networks of shell companies obscure beneficial ownership of trans-border assets. As of June 2016, 20.1% of all US external liabilities were notionally owned by entities domiciled in the eight largest tax havens by ownership, which are Luxembourg and seven islands (25.9% including Ireland; 30.5% with Switzerland) (US Treasury, 2018). A handful of studies (Hager, 2016; Palan et al., 2013; Sharman, 2006 for tax evasion; the Corpnet project: <http://corpnet.uva.nl>) are trying to pinpoint the beneficial owners of trans-border assets. If half the funds channeled through the eight largest tax havens originate inside the United States and round trip for tax evasion purposes that accounts for about 10 percentage points of the 40 percentage point negative NIIP.

Second, related, we need a better accounting of what actually constitutes 'dark matter' – the implicit assets generated by notionally higher rates of return for US direct investment abroad as compared with foreign direct investment in the United States. While Hausmann and Sturzenegger (2007) attributed dark matter to better management, an equally plausible answer is that US firms possess a greater degree of monopoly power in global markets on account of the expansion of US intellectual property rights law through the World Trade Organization's Trade Related Aspects of Intellectual Property Rights agreement and other bi- and multilateral treaties (Drahos & Braithwaite, 2002; Sell, 2003). US firms capture a disproportionate share of global profits, ensuring that US firms have differential growth relative to foreign competitors. Ultimately everything at stake here resolves into the question of profits, because current profits fund interest payments and expected profits back equity asset values.

The 3795 firms ever appearing on the Forbes Global 2000 (FG2k)⁵ amount to about 13.5% of the 28,000 global firms with annual revenues over \$200 million identified by McKinsey, but they capture roughly one-third of total profits for those 28,000 firms (Dobbs et al., 2015). From 2005 to 2017 the top 25 US firms in the FG2k – 0.01% of McKinsey's 28,000 firms and 1.25% of the FG2k – captured 13.2% of all profits for the FG2k group, 38.9% of profits for the 1081 US firms that ever appeared on the FG2k list, and roughly 4.5% of all profits for the 28,000 firms McKinsey analyzed. These top 25 firms are predominantly firms producing information based goods, like Pfizer, Google and Apple, as well as the oil companies, who benefited from historically high oil prices 2005–2017. US firms' profits are disproportionately large relative to the US share of the global economy. This disproportionate profitability surely matters for the dollar's exchange rate and for the probability of any sudden stop in foreign lending. It also backs the relatively large share these firms have in US and global equity markets. Even after declines in late 2018, the top 25 US firms accounted for about 9% of global market capitalization and 22% of US market capitalization; all US firms accounted for 43% of global market capitalization. Simultaneously, the inherent fragility of profits based on intellectual property rights constitutes a much greater vulnerability than negative wealth effects from a stronger dollar. Insofar as H&M (2016, p. 588) think differential growth matters for US power, this disproportion needs to be documented and explained.

Finally, the real and more general issue with respect to balance sheets, both internal and external, is whether the very large asset values on balance sheets today are sustainable. As emphasized above, asset values depend on income streams and income streams reflect both the ability and willingness of debtors (and workers) to accept and service claims on their income. Rising income inequality is probably a more profound threat to asset values than the limited wealth effects likely to flow from normal fluctuations in the US dollar and the main currencies denominating US global assets. Mortgage defaults nearly brought down the global economy in 2008. But the US Republican party seems determined to exacerbate rather than ameliorate the growing inability of the poorer 80% of the US population to service their liabilities, including those owed abroad. So while the ever growing stock of cross-border assets matters, the flows beneath those stocks matter much more. They are the independent variable here. Expectations about those flows are the primary basis for big swings in asset values as well as changes in exchange rates. International political economy scholars would still learn more from examining and explaining global flows than stocks.

Notes

1. For consistency and clarity 'stock' in this article indicates a quantity of a given financial asset or assets at a point in time, and 'equity' or 'equities' indicates ownership of shares in publicly held companies. I will not use 'stock' in the vernacular US meaning of equities.
2. That said, riskiness is neither always readily apparent nor honestly reported. Triple A rated mortgage backed securities and collateralized debt obligations were at the heart of the 2008 global financial crisis.
3. Note also that 'flows into the US' do not have an unambiguously positive impact. By accounting definition, net positive investment flows imply a current account deficit, which is a subtraction from GDP.
4. Author's calculation from stat.BIS.org data. The eight countries with data available are Belgium, Britain, France, Germany, Italy, the Netherlands, Spain and Sweden. These comprise a non-trivial and diverse set of EU economies.
5. The FG2k are the 2000 largest firms in the world based on sales, profits, market capitalization and assets. For the selection methodology see Scott DeCarlo, 'Methodology: How We Crunch the Numbers,' *Forbes*, 4/18/2012, p. 36.

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