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Dr. Guy Stevens
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Federal Reserve Board
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Dear Guy:

Thanks for sending me your memo on the Julius calculations. If nothing else, it confirms your reputation for kindness and charity. The article from the Journal of Commerce sounds awfully muddled to me.

It seems to me that there are two ideas that have to be defined before any sensible discussion starts. One is what we mean by "the U.S." or "us." The other is what we mean by competitiveness. What are we trying to find out?

Some of the questions we may want to answer, I think, are about the resources located within the boundaries of the U.S. (or any other country). That is what most of our trade theory is about, assuming that resources do not move among countries. Most trade share and balance of payments measures refer to this geographical concept. Another entity is something we think of as U.S. companies, those that are in some sense managed from the U.S., controlled at the top by U.S. residents, with U.S. residents holding controlling equity shares. They may use, in production, labor, capital, land, and other resources located in any country, but the organizing of the enterprise is done in the U.S.

For each of these entities, we can study performance, or competitiveness, in several ways. One that you mention is the share of the world's output they account for. Another, that we use, is their share of the world's exports. As you say, we would like to measure the share of the world's production or consumption produced in the U.S. or produced by U.S.-controlled firms. We do go on to say, however, that the export share measure has some advantages, in that a protectionist country can keep foreigners out of its home markets or hobble them in that market, but is less able to affect export markets, although it can, of course have some effects on them. Still, we think that export production is more footloose than production for local markets and may give a better picture of what would happen in unrestricted markets.

What about the balance of payments? I don't think of that as a competitiveness measure. A country could be stagnant, but conservative, and run a zero trade and services balance as it declines. It could be running a deficit, but expanding. I think of the current account deficit as representing some combination of government macro policy and the preferences of the citizens with respect to saving and consuming. A deficit says we, as a country, are consuming more than we are producing, whether our production and productivity are rising, falling, or constant. I am not sure what the parallel measure for firms is. It would not be their share of production or trade but perhaps whether they are profitable. Do their revenues cover their current costs, whether the revenues are earned at home or abroad and whether the costs are incurred at home or abroad.

I can think of a third topic which is what role the U.S.-controlled and foreign-controlled multinational firms play in the U.S. balance on current account (and on capital account). I do not mean what effect they have, since that is a more complicated issue, as Hufbauer and Alder pointed out twenty years ago. We might then add up the exports from the U.S. and imports into the U.S. of goods and services by U.S. multinationals and also their current earnings overseas, and we might do the same for foreign-controlled firms in the U.S.. A requirement for this would be eliminating the substantial duplication that now exists in the data between U.S.-controlled and foreign-controlled firms, ending the fiction that Canada controls du Pont and that U.S. auto companies control their Japanese affiliates. Perhaps we should stick with majority ownership after all.

This doesn't leave any room for Julius' measure. I don't see the sense of a balance-of-payments measure for an entity that, by its nature, operates across national boundaries. I suppose one could try to treat the firm as if it were a country and measure all its purchases from outside the firm (labor services, capital services except equity, intermediate products and services) and all its sales to outsiders, but I am not sure what that would indicate. We can also compare total sales with value added, to judge how much of what it sells the firm produces, but these don't sound like her measure.

I might add that I do not see any meaning, except a statistical one, to the concept of FDI-related trade. It includes the U.S. exports of Japanese trading firms that buy and ship to Japan, but do not produce, agricultural and mineral products, and it includes the U.S. exports of Continental Grain and others that do not produce wheat but supply intermediary services. Her discussion seems to ignore the distinction between the production activities of firms and their role as intermediaries, both

important, but with different implications as to the resources involved.

These rambling thoughts are probably not much help with your Julius problem, but I couldn't resist trying to explain how I look at these issues. Perhaps someone should try to clarify them more formally.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bob", written in dark ink.

Robert E. Lipsey