The Big Borrower: The United States Depends Too Heavily on Other Nations for Money and Brains

By: Andrew Brod

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Article:

Over the last couple of decades, much has been made of the "twin deficits" faced by the American economy. Usually the deficits people have in mind are the trade deficit and the government's budget deficit. The pair grew dramatically during the 1980s, scaring a lot of people in the process. Nowadays, as a percentage of Gross Domestic Product, the trade deficit has grown even larger than in the 1980s and the budget deficit is close to doing the same.

But I've been thinking of a different pair of twin deficits. The trade and budget deficits are really two sides of the same coin, a reflection of our national reluctance to save. So let's bunch them together as a "financial capital" deficit. What's the other deficit? It too is a way in which the U.S. is failing to invest in its own future. I call it a "human capital" deficit, because we've depended for many years on foreign scientific and engineering talent instead of training our own.

To be sure, this is not to say that we don't supply *any* of our own financing or train *any* of our own people. But in each arena, a gap has been growing between what we generate and what we use, and the difference has been made up by foreign injections, of money on one side and talent on the other.

On the financial side, we depended in large part on foreign capital to fuel the economic boom of the 1990s. Foreign capital financed our large budget deficits of the 1980s and is doing so again in the 2000s. The most notable source of these loans from abroad is the sale of U.S. government securities like Treasury bonds to governments that are trying to maintain weak currencies in order to promote their exports. In a sense, *our* biggest export right now is dollars.

Our culture of borrowing is becoming ingrained among consumers as well. Not so many years ago, households saved about 10 percent of their incomes. Now the private savings rate is closer to 1 percent.

On the human-capital side, foreign talent has come to dominate American graduate schools. According to the National Science Foundation, in 2001 nearly 60 percent of all slots in American graduate programs were filled by international students. In science and engineering programs, the percentage is significantly higher. The United Nations estimates that from 1960-1990, well over a million high-level professional and technical workers migrated to the U.S.

At the same time, academic performance by our students is turning downward. Oh sure, they get good grades, but when their performance can be compared to students in other countries, they don't do so well, especially in math and science. In a recent New York Times column, Thomas Friedman noted that the top U.S. college team this year in an international computer-programming competition placed 17th, the worst showing for the U.S. in the 29-year history of the event. We used to win it. But now, American students tend to opt for degrees in business and the social sciences.

Now, being a borrower isn't necessarily a terrible thing. If your lender never says no, then why stop borrowing? Why should we save more than 1 percent of our incomes if the rest of the world will do our saving for us? (Hey,

we've outsourced saving!) For years, the rest of the world showed little inclination to stop the flow of capital into this country, which has kept our interest rates and our savings rate low.

Similarly, if foreign students and researchers are eager to come to the U.S., why should we worry about the fact that our own students are falling behind the rest of the world? It's been easy to import talented foreign labor, or outsource some tasks to Indian engineers and accountants.

The problem with being a big borrower is the risk that the spigot of loans will be turned off. If the borrower isn't prepared for that event, the adjustment can be painful. And there are signs on the horizon that could affect both our financial-capital and human-capital deficits.

There are two important factors at play on the financial side of the equation. One involves our huge trade deficits and the vast number of dollars held abroad, which for years have been cited as the reason the dollar would soon weaken. Until now that never happened, as foreigners displayed an unquenchable thirst for dollars. But it's happening now. The dollar is worth a quarter to a third less than it was a year ago, in part due to the emergence of the euro as an important international currency. A weaker dollar means a smaller inflow of foreign capital and lending.

The other factor is the Bush administration's effort to get China to strengthen its currency. The Chinese renminbi is roughly 40 percent cheaper than it would be if international markets were allowed to determine its price. This helps Chinese exports, which of course hurts American manufacturers (though it helps American consumers).

China keeps its renminbi weak by keeping the dollar relatively strong, and it does this buying those Treasury bills. So if the Bush administration succeeds here, it will eliminate a big source of foreign financial capital. I'm not saying we shouldn't do this, but the near-term pain of higher interest rates and inflation could be significant. If you're tired of hearing about the housing boom, this would take care of that.

On the human-capital side of the equation, it's also a combination of policy and world events that makes for an uncertain future. September 11th raised security fears and led us to institute visa and entry restrictions that have discouraged talented foreigners from coming here to study and work. The Council of Graduate Schools found that the number of applications by foreign students to American graduate programs in the fall of 2004 was over 30 percent lower than a year earlier.

Other security measures such as the use of finger-printing and biometric identification have alienated prospective immigrants and visitors. These measures may seem innocuous to us, but foreign researchers and students are reportedly becoming more eager to explore their options at universities in other countries. Unfortunately, the new American suspicion of foreigners is happening just as Europe and Japan are developing and improving their science and higher-education programs, meaning that those in the U.S. don't stand out as they used to.

The irony is that while the U.S. may soon spend more on defense than the rest of the world combined, Europe and Japan are spending to develop their human capital. In a global economy in which low-wage developing countries attract low-wage jobs, human capital is the primary competitive edge of developed countries. Isn't it ironic that at a time when math and science education is becoming more and more important to the future of the American economy, we're still quibbling about teaching creationism in our schools?

If current trends continue, we're also on borrowed time when it comes to training our people. Some commentators like to point out that if you add up local, state, and national spending on education, it's more than we spend on national defense. My response is: So what? We should focus on educational outcomes, and right now those outcomes should concern us.

We need to prepare our educational system to train more of the scientists and engineers we'll need in the future. That may require a reallocation of our national priorities and spending. It certainly means restoring the funding that President Bush cut last year from the National Science Foundation, and opposing the cuts in science research that he's proposed for next year's budget. This is not the time to retreat from our educational challenges. The world is changing fast, and we have to keep up.