

## Investigating investment

America is investing much more than its official statistics seem to suggest

For decades economists have fretted that America invests a smaller share of its GDP than other rich countries. Since investment is the engine of growth, low investment should mean slower growth. Yet over the past decade America's growth rate has actually been a tad higher than the average for the rich world. How come?

In the 1990s, America has invested about 17% of its GDP, significantly less than the 20% of GDP that West European economies have invested or the massive 30% in Japan. However, conventional measures of investment, which have remained more or less unchanged since national accounts were first compiled over 50 years ago, are misleading. If investment is defined more broadly, America has actually invested more than the average for rich countries.

Investment, as reported in the national accounts, includes only spending on physical capital--ie, plant and equipment, infrastructure and housing. But economists define investment as any spending that has the potential to raise future output. Many other types of spending meet this criterion. A recent study by Milka Kirova, at St Louis University, and Robert Lipsey, at the National Bureau of Economic Research, attempts to track down this missing investment.

Education yields returns over long periods of time and so should be counted as investment, but only capital spending on schools and equipment is currently included. This is a large omission: in 1990-94 America's current spending on education (excluding money for buildings and the rest) was 6.6% of GDP, compared with an average of 5.6% in 12 other rich countries. Japan, which has the highest level of physical-capital investment, spent only 3.8% of GDP on education.

Research and development also generates future output. Yet government R&D is treated as government consumption in the national accounts; business R&D is simply counted as a cost of production and is thus excluded from both investment and GDP. America has consistently invested more than other countries in R&D, amounting to 2.7% of its GDP in 1990-94, against an average of 2.1% for the rest of the rich world.

Consumer durables are another anomaly. By convention, only firms invest; all spending by households (except purchases of new homes) is counted as consumption. If a firm buys a personal computer or a car, these are reported as investment, but if a household buys such goods they count as consumption. However, a car, say, provides transport services over long periods of time, whether owned by a firm or a household.

If consumer durables were counted as capital, then, once again, this would add more to investment in America than elsewhere: in the five years to 1994 America devoted 6% of GDP to consumer durables, against 5.4% in other rich countries.

Military spending is conventionally treated as government consumption rather than investment. This is a more controversial area, but if such spending is meant to yield some form of "output" over a long period, then it too should count as investment. In 1990-94 America spent 1.3% of GDP on military hardware, compared with an average of 0.5% of GDP in other rich economies.

All these four forms of "investment" are thus more significant in America than elsewhere. So adding them to the conventional measure of investment would narrow the gap between America and the rest of the rich world. But the authors do not stop there. Investment goods are generally cheaper in America, relative to other goods and services, than is the case abroad; so a given amount of dollar spending provides more factories or computers than it does elsewhere. If investment figures were adjusted for price differences between countries, America's total investment, including the four extra elements above, would increase to around 35% of GDP in 1990-94 (see chart), just above the average of 33% for 12 other rich countries. If the same adjustment were made to last year's investment figures, America would pull even further ahead, because its capital spending, even as officially reported, has surged during the latest expansion.

Not only is America's true investment higher than conventionally claimed; so too is its saving. The redefinition of investment implies corresponding changes in the measurement of saving, because items previously counted as consumption have been redefined. So should policy makers stop worrying about America's low savings rate? No. The gap between savings rates in America and abroad may be smaller than previously thought, but the gap between America's domestic saving and domestic investment remains just as large--as is shown by its huge current-account deficit. So long as America fails to save enough to finance its investment, it will remain dependent on inflows of foreign capital.

As well as demonstrating the perils of international comparisons, the study by Ms Kirova and Mr Lipsey highlights how conventional statistics may have become more misleading as intangible investment in such things as human capital has grown in significance.

Another example, not included in their study, is computer software. America's Department of Commerce, like most other countries' statistical offices, treats firms' spending on software in the same way as their spending on electricity: it is considered a cost of production and so is excluded from investment. But unlike electricity, which is consumed once and for all in production, software can last a long time. Software is also so closely tied to computer hardware that it makes little sense not to count it as capital spending. Once again, this would favour America, where spending on software is higher than in countries with less advanced information technology.

In September, Britain's national accounts will change to count business software spending as an investment. A similar overhaul of America's national accounts is long overdue. It may lead the world in the production and use of information technology, but its rusty statistics are more appropriate to the iron age than the information age.