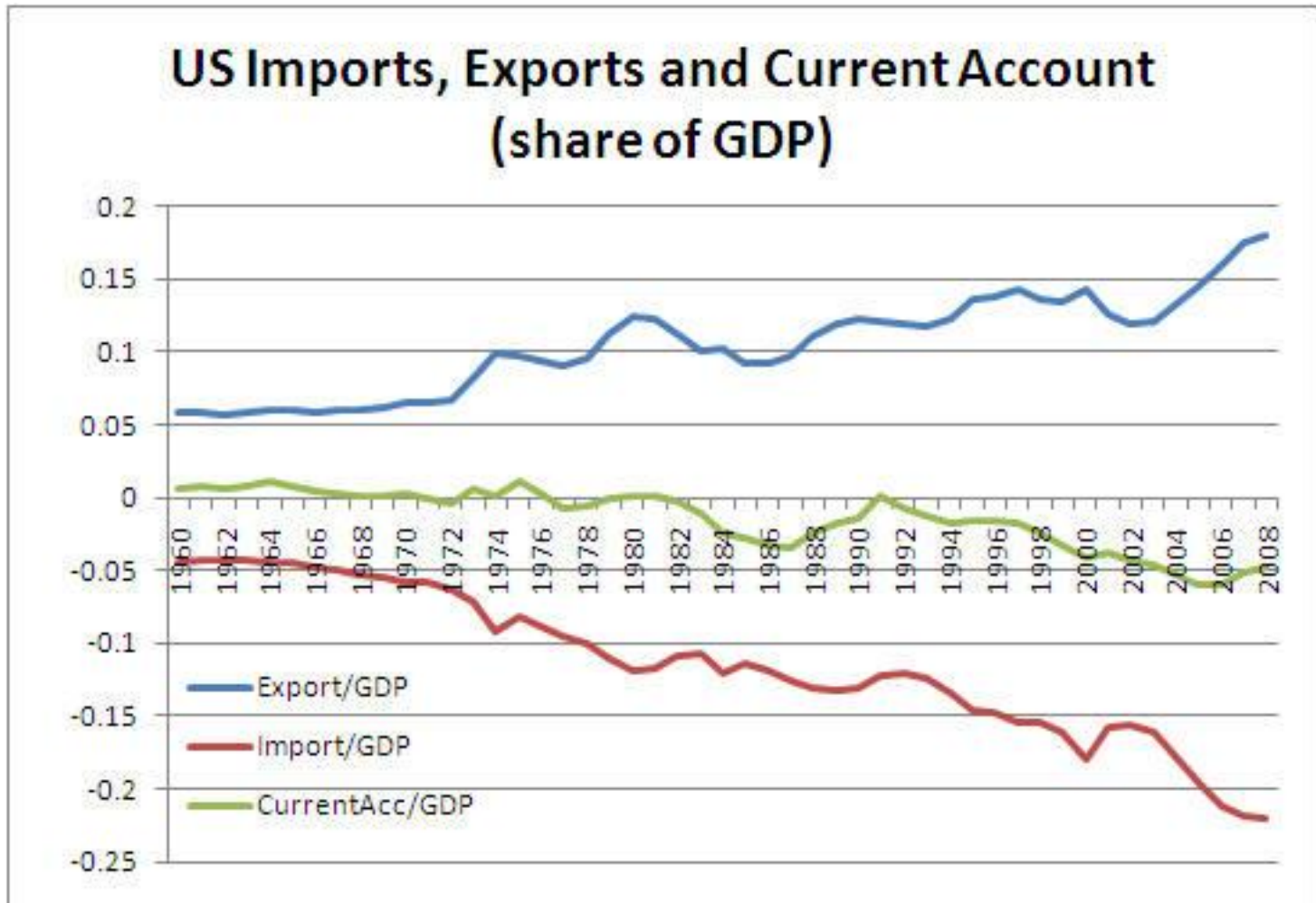
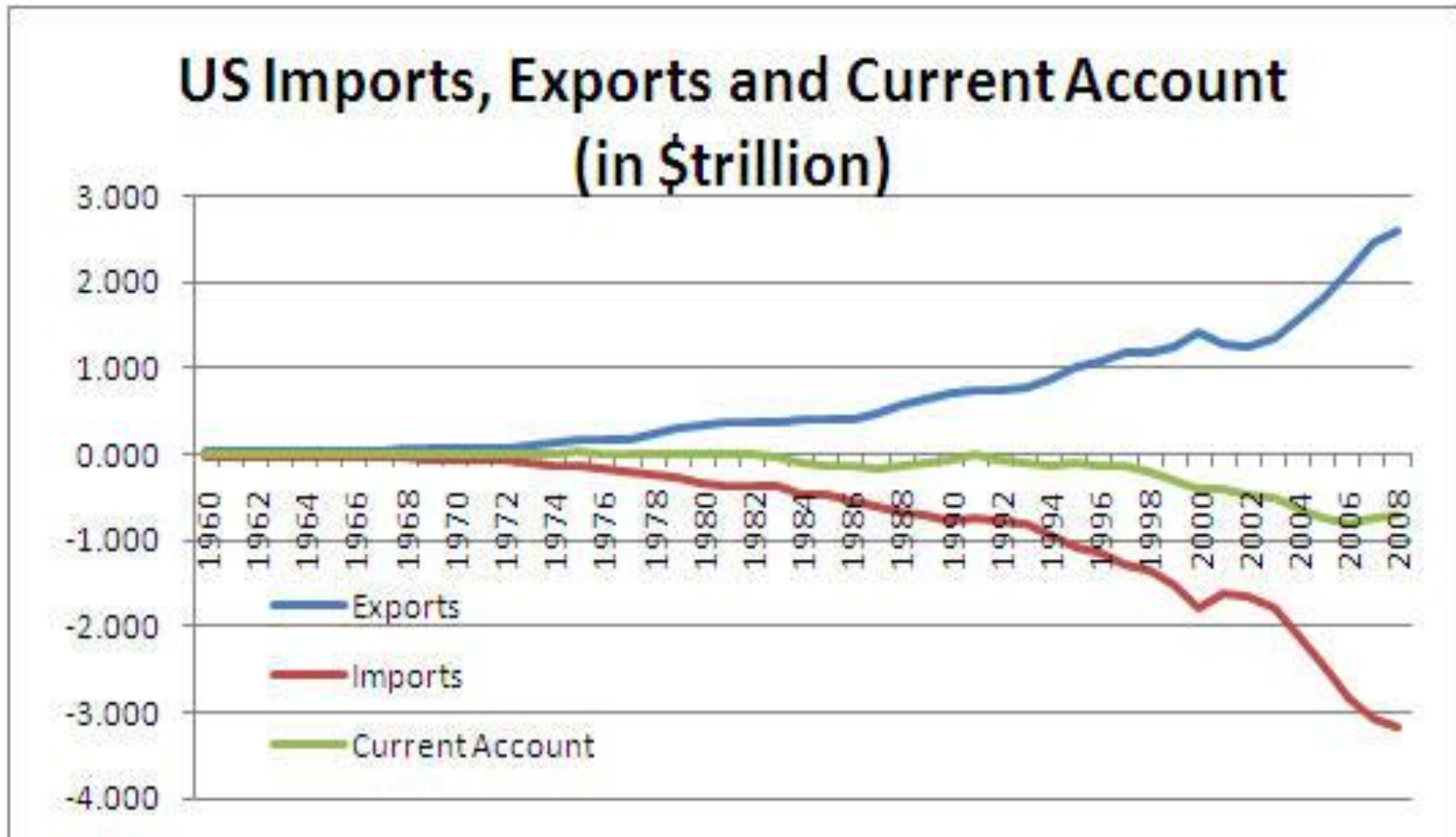


# Chapter 10

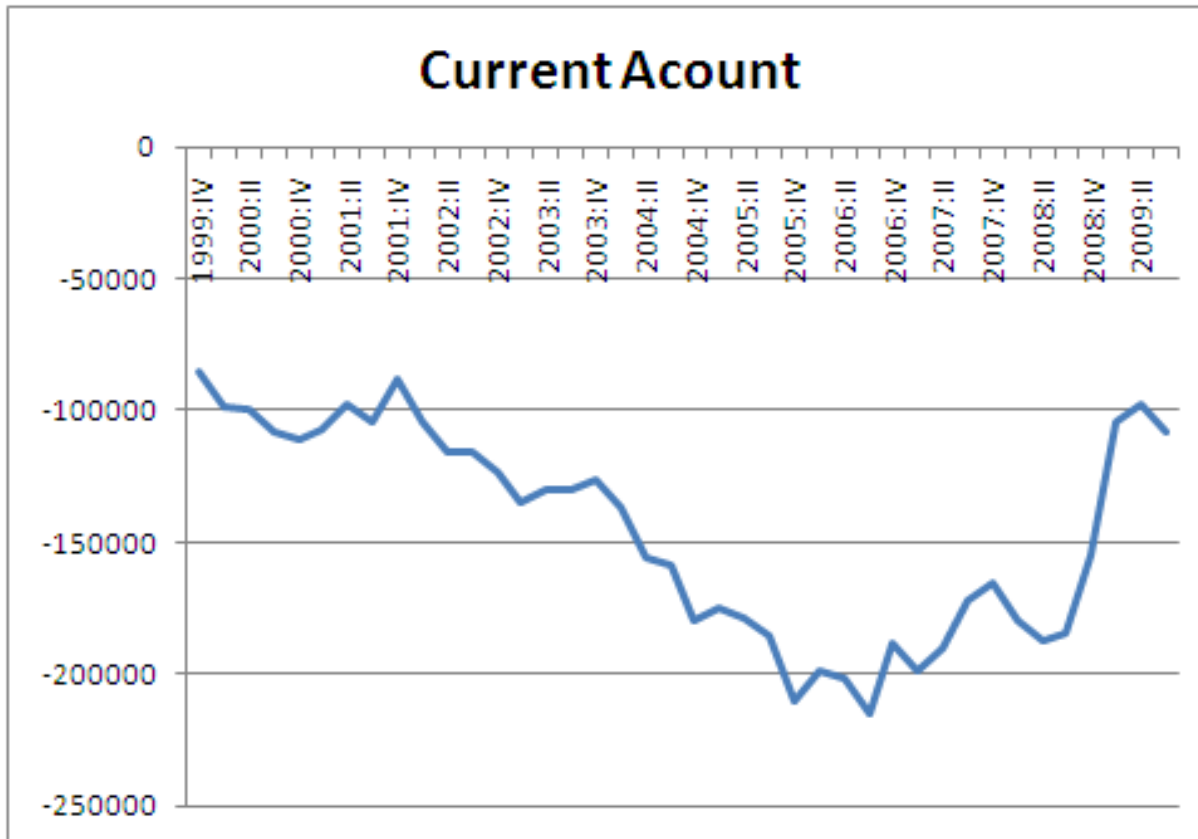
## Balance of Payments (BOP)



# In Current Dollars Balance of Payments (BOP)



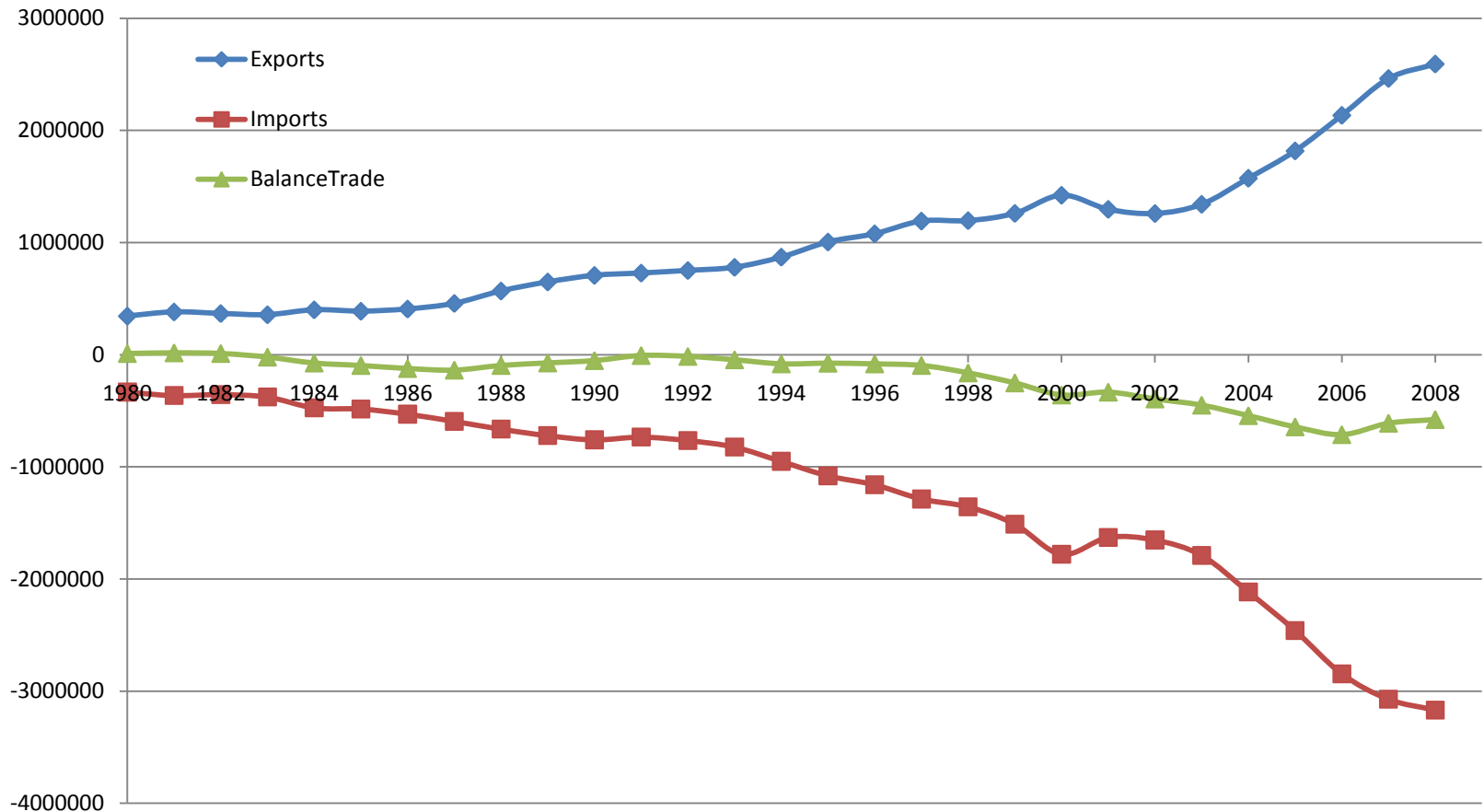
# Recent Current Account Data Balance of Payments (BOP)



Current Accounts and Trade Balances  
see [Economist \(pdf\)](#)

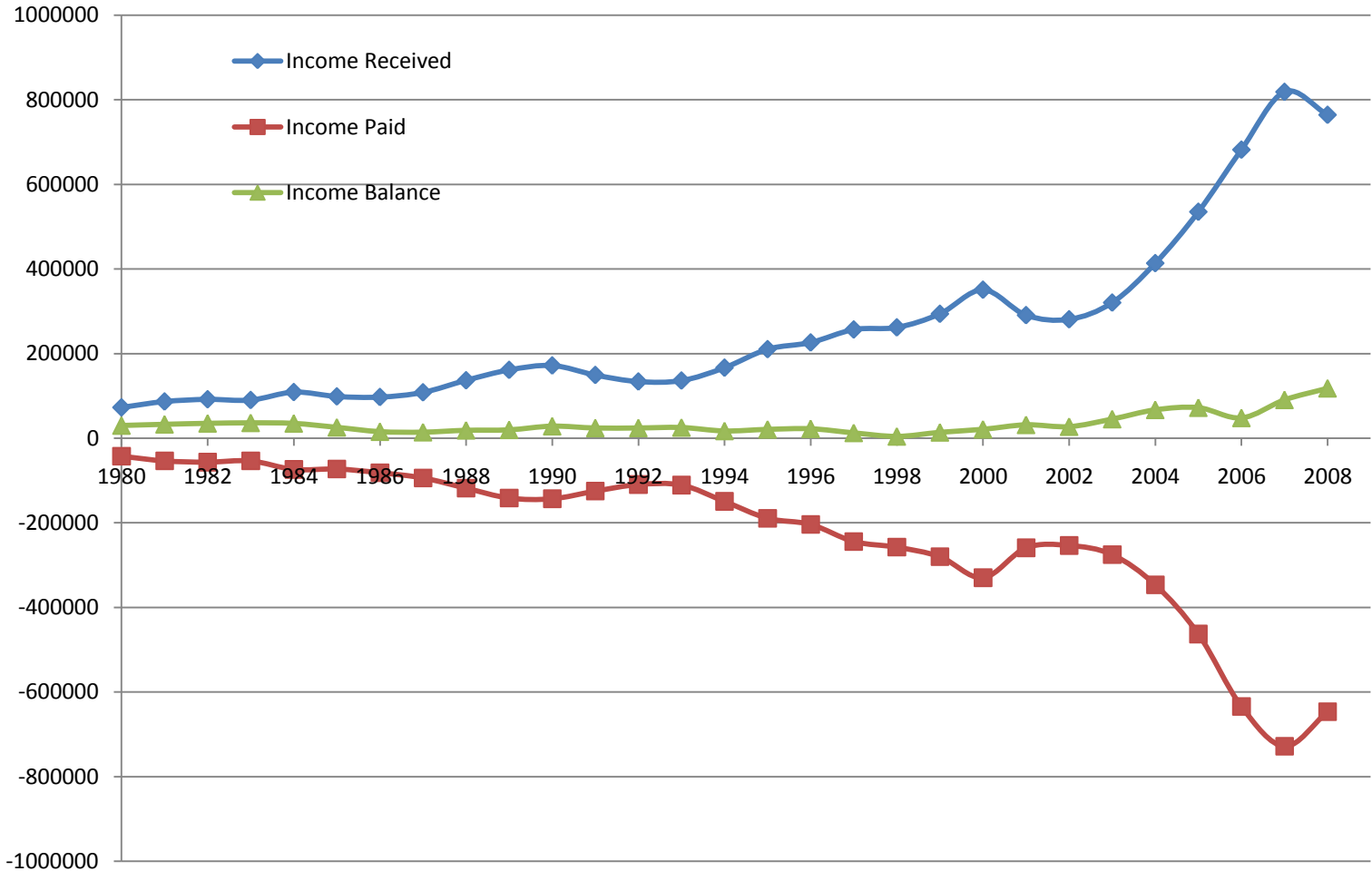


# US Import and Exports of Goods and Services





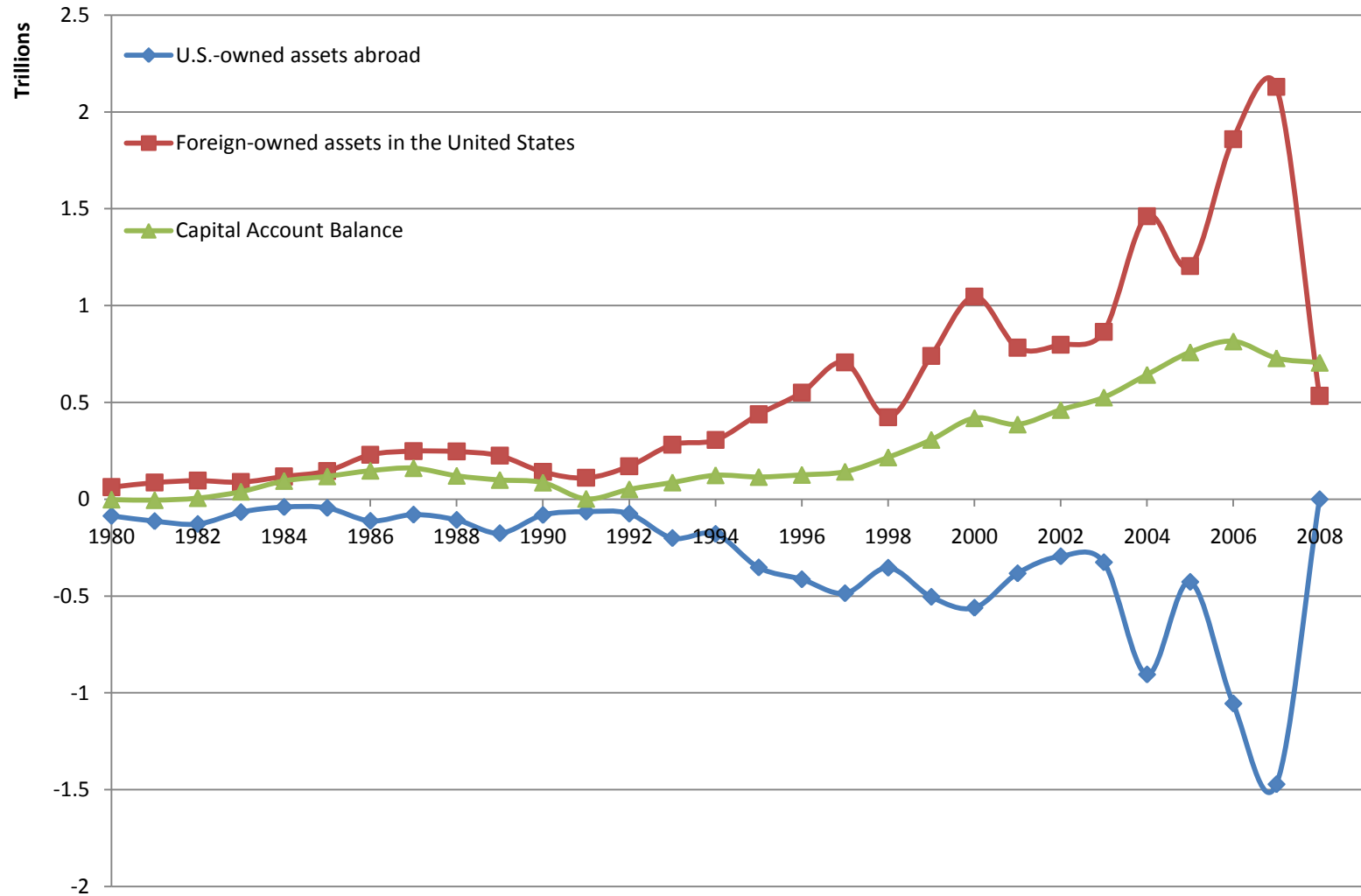
# US Income Received, Paid, Balance on Income







# US Capital/Financial Account



# Causation

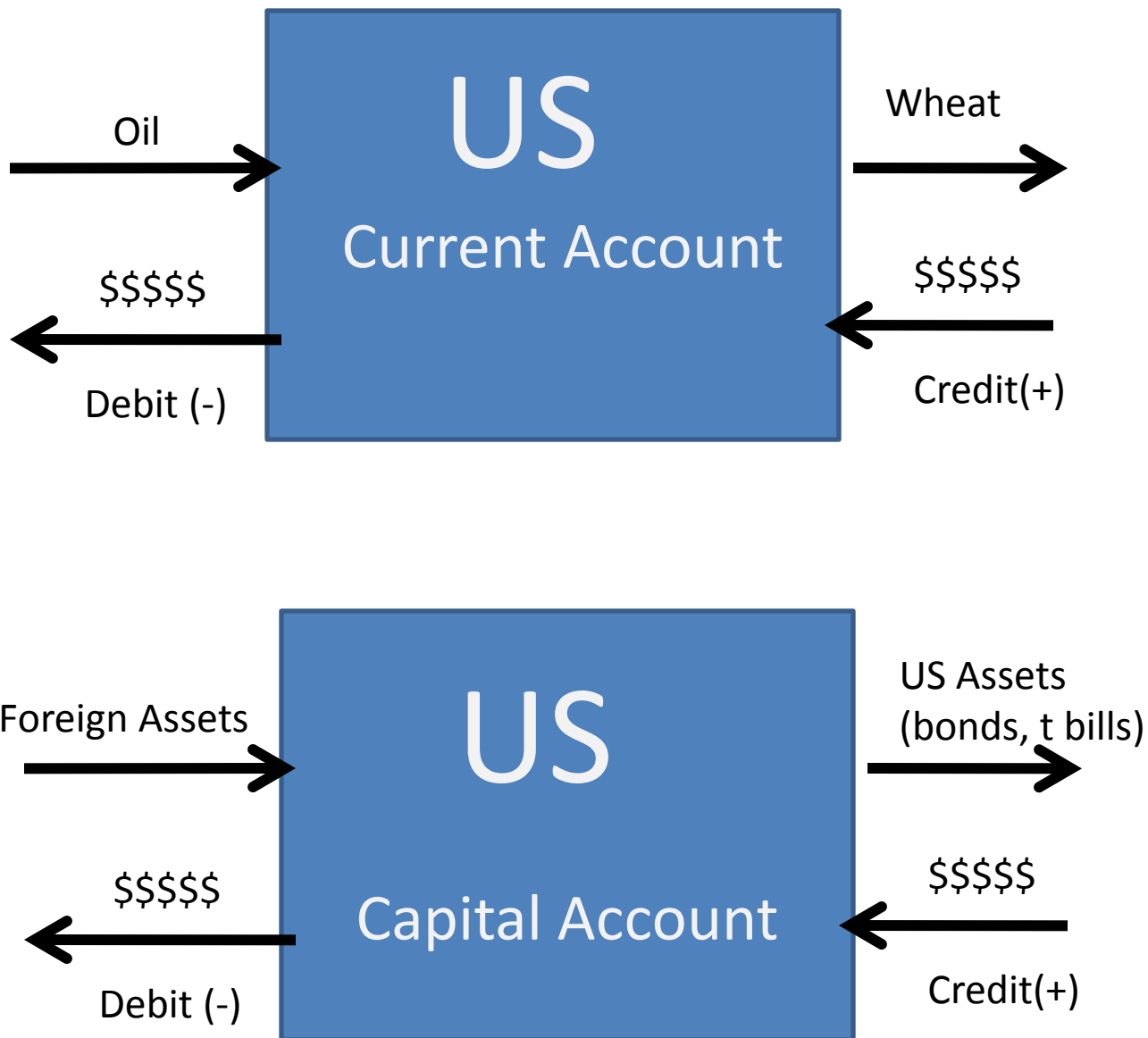
- Do financial inflows (foreign investment attracted by high returns in the US) cause the US current account deficit?
- Does high US import demand and the resulting current account deficit cause the capital account surplus?
- Simultaneity

## Circular Flow

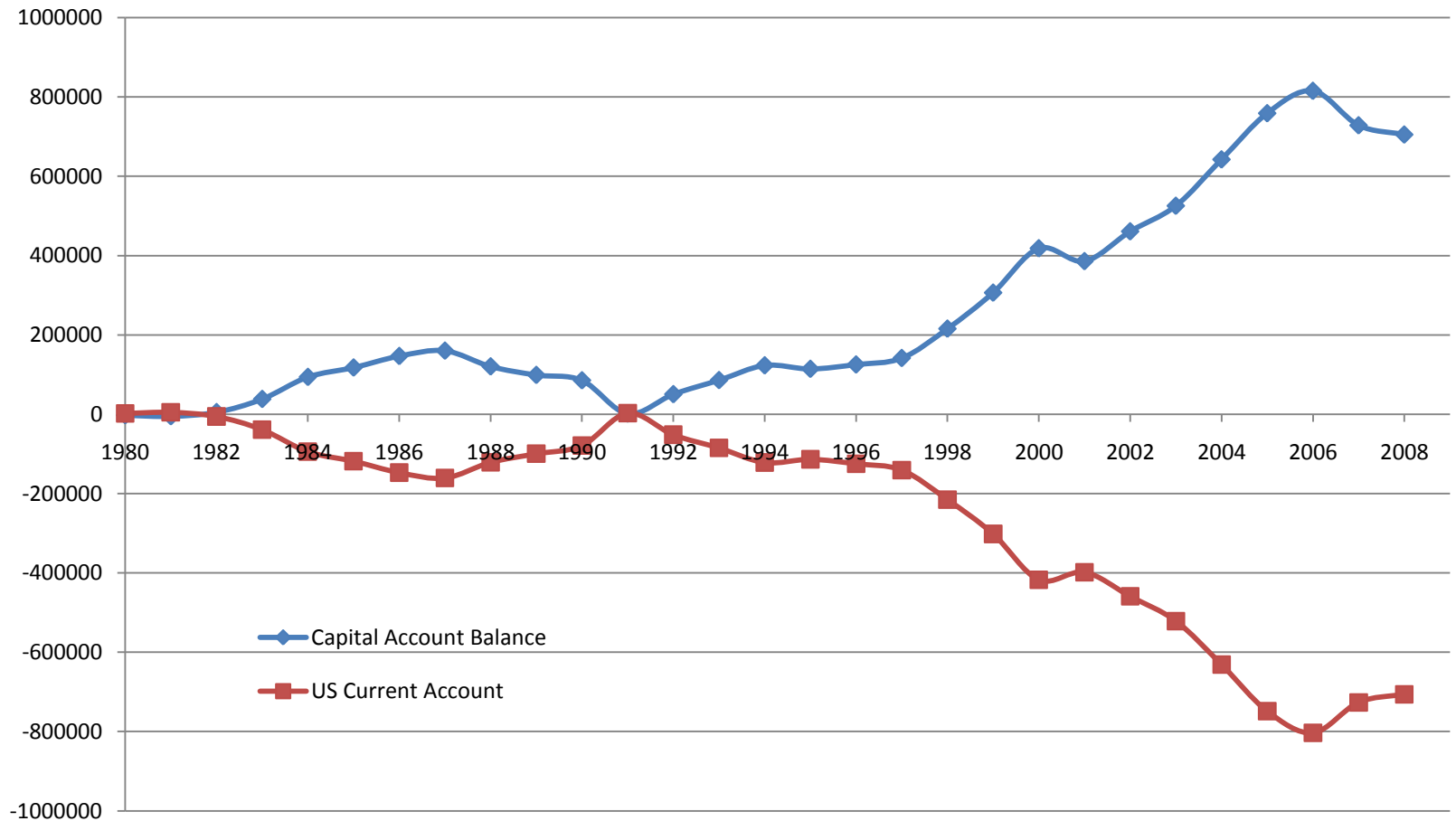
\$\$\$ that leave the US come back. The flows on the current account are jointly determined.

The more \$\$\$ earned by the US from exports will reduce the \$\$\$ available in the world to buy US assets.

The more \$\$\$ that enter the US to buy US assets will reduce the \$\$\$ available to buy US exports.



# US Current and Capital Account Balances



# What does a Current Account Deficit (Surplus) Mean?

- Total debits will always equal total credits
  - If the current account registers a deficit, the capital and financial account must register a surplus, or net capital/financial inflow
  - If the current account registers a surplus, the capital and financial account must register a deficit, or net capital/financial outflow

# Economic Meaning of the Current Account

- $Y$ =aggregate income
- $C$ =consumption spending
- $I$ =investment spending
- $G$ =government spending
- $X$ =exports
- $M$ =imports
- $T$ =taxes
- $S$ =domestic saving

$$(1) \quad Y = C + I + G + (X-M)$$

In (1), aggregate income equals aggregate spending

$$(2) \quad Y \text{ also} = C + S + T$$

In (2) aggregate income goes either to consumption savings, or taxes.

Since (1) and (2) are both  $Y$ , we get (3)

$$(3) \quad C + I + G + (X-M) = C + S + T$$

After some rearranging we get (4)

$$(4) \quad (X-M) = (T-G) + (S-I)$$

# Economic Meaning of the Current Account

- $Y$ =aggregate income
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- $M$ =imports
- $T$ =taxes
- $S$ =domestic saving

$$(4) (X-M) = (T-G) + (S-I)$$

In (4)

$(X-M)$  is the current account balance (For US  $<0$ )

$(T-G)$  is the government budget balance (For US  $<0$ )

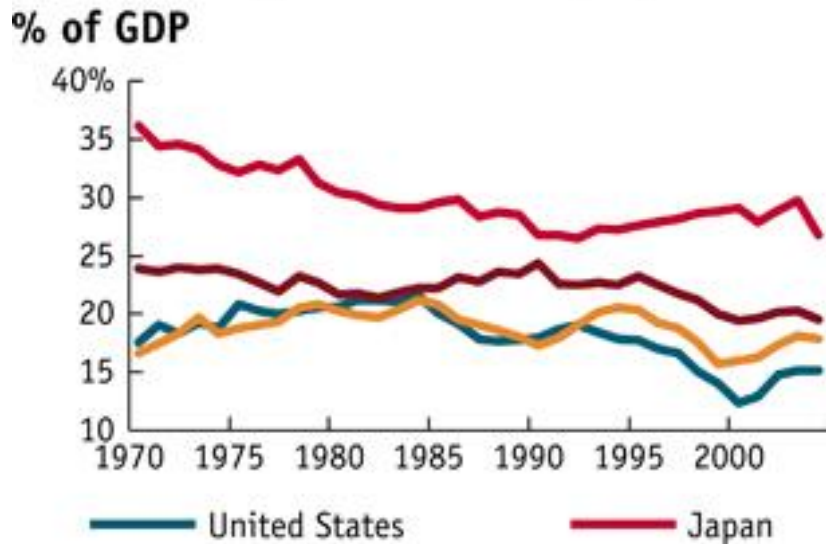
$(S-I)$  is the excess of savings over investment (For US  $<0$ )

This approach highlights the role that low US private Savings and the US government budget deficit play in causing the current account deficit.

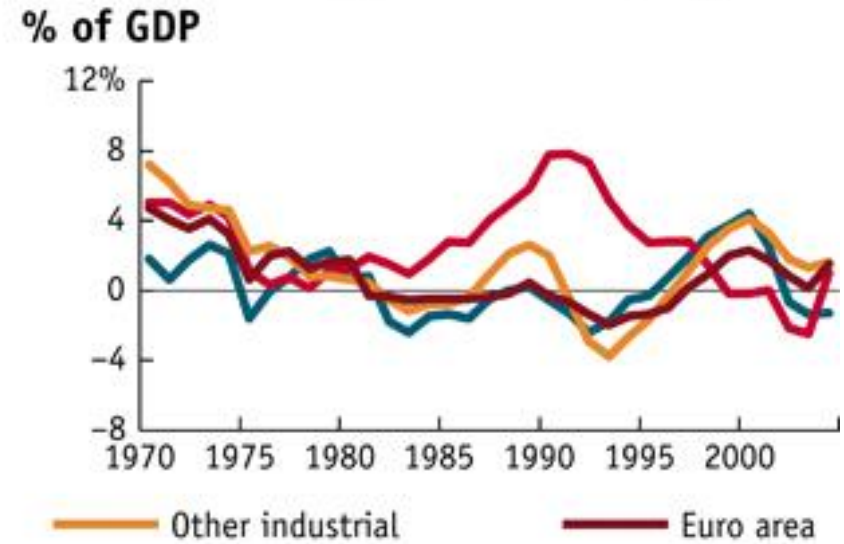


# Savings, investment, Current Account

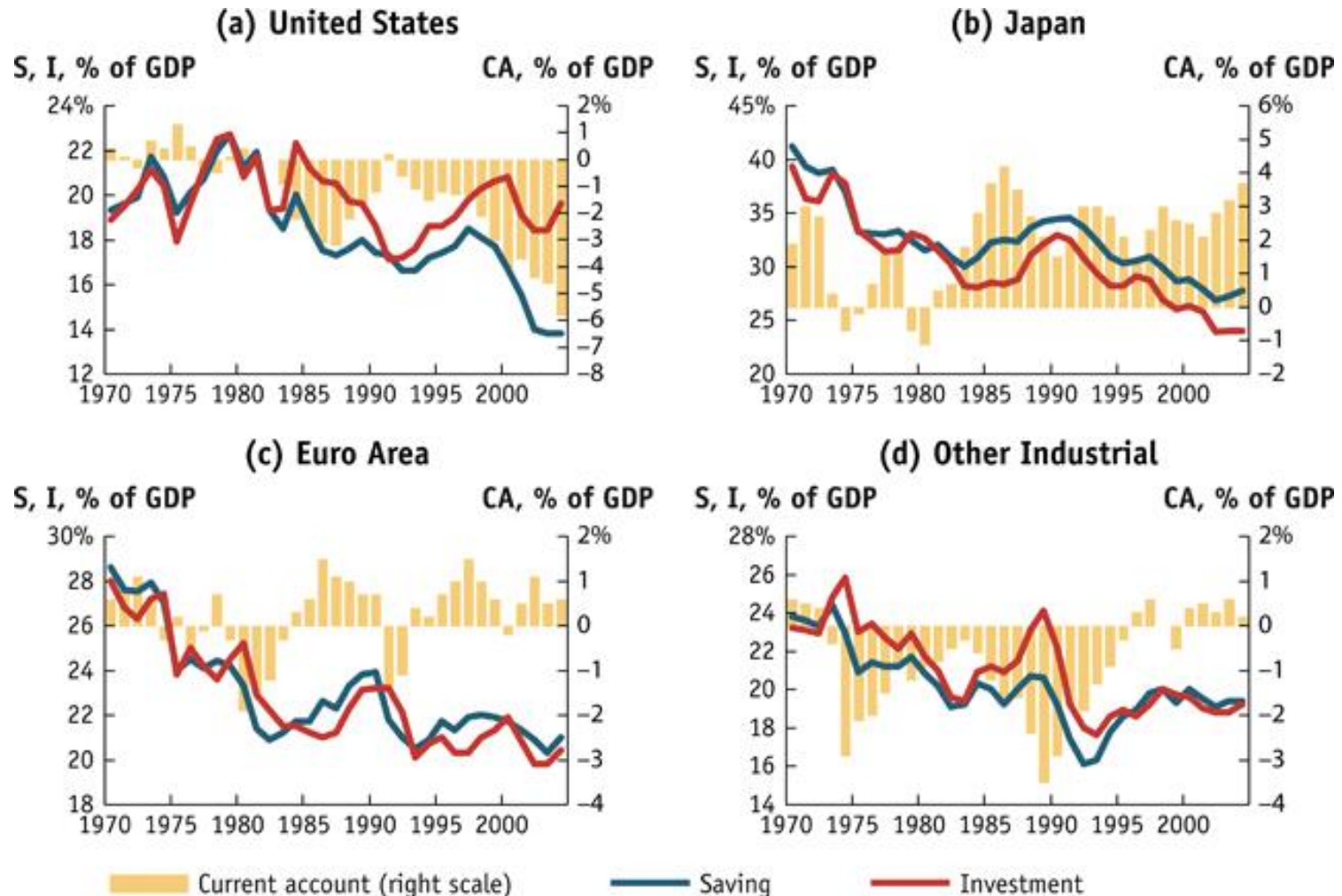
(a) Private Saving,  $S_p$



(b) Public Saving,  $S_g$



# Savings, investment, Current Account



# Is a Current Account Deficit a Problem?

- Benefit of a current account deficit
  - Ability to push current spending beyond current production
  - Cost of debt service
  - Debt: Good or bad for a nation?
    - Is the deficit used to finance more consumption or more investment?
    - Drivers of U.S. current account deficits in the 1980s and 1990s

# Can the United States Continue to Run Current Account Deficits?

- U.S. as an attractive investment destination
- U.S. Debt is denominated in US \$
  - See article by [Poole](#)
- Threats
  - Emergence of the Euro as a close substitute for the US \$. Foreigners could “dump” their \$ denominated assets fearing that the value of the \$ will fall
  - Macro economic adjustments to a decrease in the value of the \$.
    - Imports (e.g. oil) more expensive
    - US interest rate hikes to reduce inflation and maintain value of the \$
  - (see article by [Bergsten](#))

# United States as a Debtor Nation

- Early stages of its industrial development
  - Net international debtor
- After World War I
  - Net international creditor
- By 1987
  - Net international debtor (\$23 billion), for the first time since World War I
  - Net international debtor since then
  - Foreign inflows; issue of propriety

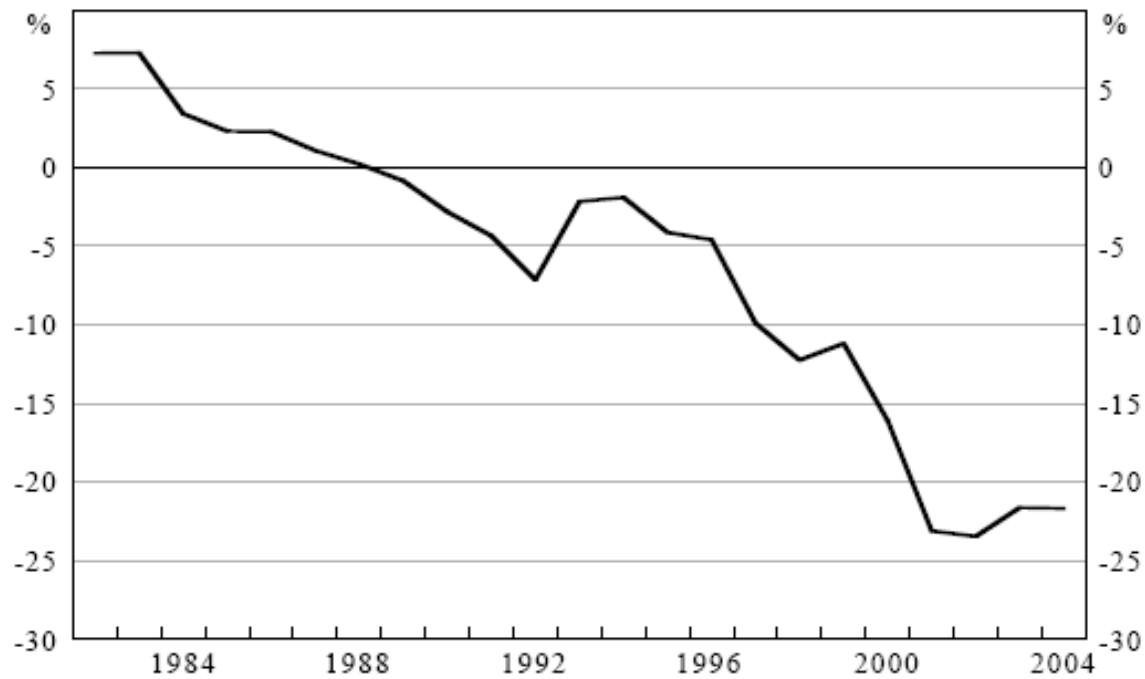
# United States as a Debtor Nation

Type of Investment*	1995	2000	2006
<i>U.S.-owned assets abroad</i>			
U.S. government assets	\$ 257	\$ 214	\$ 1,530
U.S. private assets	<u>3,149</u>	<u>5,954</u>	<u>12,225</u>
Total	<u>\$3,406</u>	<u>\$ 6,168</u>	<u>\$13,755</u>
<i>Foreign-owned assets in the United States</i>			
Foreign official assets	\$ 672	\$ 922	\$ 3,949
Other foreign assets	<u>3,234</u>	<u>7,088</u>	<u>12,346</u>
Total	<u>\$3,906</u>	<u>\$ 8,010</u>	<u>\$16,295</u>
<i>Net international investment position</i>	-500	-1,842	-2,540

# United States as a Debtor Nation

U.S. Net International Investment Position

Percent of GDP



Source: Bureau of Economic Analysis (BEA), International Economic Accounts

# US and Foreign Assets

