International Business

Global Edition

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(adapted for LIUC2018 by R.Helg)

Chapter 6

International Trade Theory

Why Is Free Trade Beneficial?

- Free trade - a situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country
- Trade theory shows why it is beneficial for a country to engage in international trade even for products it is able to produce for itself

Why Is Free Trade Beneficial?

- International trade allows a country
  - to specialize in the manufacture and export of products and services that it can produce efficiently
  - import products and services that can be produced more efficiently in other countries
    - limits on imports may be beneficial to producers, but not beneficial for consumers

Why Do Certain Patterns of Trade Exist?

- Some patterns of trade are fairly easy to explain
  - it is obvious why Saudi Arabia exports oil, Ghana exports cocoa, and Brazil exports coffee
- But, why does Switzerland export chemicals, pharmaceuticals, watches, and jewelry?
- Why does Japan export automobiles, consumer electronics, and machine tools?

What Role Does Government Have In Trade?

- The mercantilist philosophy makes a crude case for government involvement in promoting exports and limiting imports
- Smith, Ricardo, and Heckscher-Ohlin promote unrestricted free trade
- New trade theory and Porter's theory of national competitive advantage justify limited and selective government intervention to support the development of certain export-oriented industries

What Is Mercantilism?

- Mercantilism (mid-16th century) suggests that it is in a country's best interest to maintain a trade surplus -to export more than it imports
  - advocates government intervention to achieve a surplus in the balance of trade
- Mercantilism views trade as a zero-sum game - one in which a gain by one country results in a loss by another

Mercantilism

- In 1752, **David Hume** pointed out that:
  - Increased exports lead to inflation and higher prices
  - Increased imports lead to lower prices
- Result: Country A sells less because of high prices and Country B sells more because of lower prices
- In the long run, no one can keep a trade surplus

What Is Smith's Theory Of Absolute Advantage?

- Adam Smith (1776) argued that a country has an absolute advantage in the production of a product when it is more efficient than any other country in producing it
  - countries should specialize in the production of goods for which they have an absolute advantage and then trade these goods for goods produced by other countries

How Does The Theory Of Absolute Advantage Work?

- Assume that two countries, Ghana and South Korea, both have 200 units of resources that could either be used to produce rice or cocoa
- In Ghana, it takes 10 units of resources to produce one ton of cocoa and 20 units of resources to produce one ton of rice
  - Ghana could produce 20 tons of cocoa and no rice, 10 tons of rice and no cocoa, or some combination of rice and cocoa between the two extremes

How Does The Theory Of Absolute Advantage Work?

- In South Korea it takes 40 units of resources to produce one ton of cocoa and 10 resources to produce one ton of rice
  - South Korea could produce 5 tons of cocoa and no rice, 20 tons of rice and no cocoa, or some combination in between

How Does The Theory Of Absolute Advantage Work?

- Without trade
  - Ghana would produce 10 tons of cocoa and 5 tons of rice
  - South Korea would produce 10 tons of rice and 2.5 tons of cocoa
- With specialization and trade
  - Ghana would produce 20 tons of cocoa
  - South Korea would produce 20 tons of rice
  - Ghana could trade 6 tons of cocoa to South Korea for 6 tons of rice

How Does The Theory Of Absolute Advantage Work?

- After trade
  - Ghana would have 14 tons of cocoa left, and 6 tons of rice
  - South Korea would have 14 tons of rice left and 6 tons of cocoa
- If each country specializes in the production of the good in which it has an absolute advantage and trades for the other, both countries gain
  - trade is a positive sum game

How Does The Theory Of Absolute Advantage Work?

Absolute Advantage and the Gains from Trade

Resources Required to Produce 1 Ton of Cocoa and Rice		
	Cocoa	Rice
Ghana	10	20
South Korea	40	10
Production and Consumption without Trade		
	Cocoa	Rice
Ghana	10.0	5.0
South Korea	2.5	10.0
Total production	12.5	15.0
Production with Specialization		
	Cocoa	Rice
Ghana	20.0	0.0
South Korea	0.0	20.0
Total production	20.0	20.0
Consumption After Ghana Trades 6 Tons of Cocoa for 6 Tons of South Korean Rice		
	Cocoa	Rice
Ghana	14.0	6.0
South Korea	6.0	14.0
Increase in Consumption as a Result of Specialization and Trade		
	Cocoa	Rice
Ghana	4.0	1.0
South Korea	3.5	4.0

Absolute Advantage

In the table we have:

$a_{LC} = 10$; $a_{LR} = 20$; $a^*_{LC} = 40$; $a^*_{LR} = 10$

where: a_{LC} ≡ **unit labour requirements** for Cocoa

≡ (L_c/Q_c)

In this case:

Ghana has an **ABSOLUTE ADVANTAGE** in cocoa

$(a_{LC} < a^*_{LC})$

and

South Korea has an **ABSOLUTE ADVANTAGE** in rice

$(a^*_{LR} < a_{LR})$

What Is Ricardo's Theory Of Comparative Advantage?

- David Ricardo asked what happens when one country has an absolute advantage in the production of all goods
- The theory of comparative advantage (1817) - countries should specialize in the production of those goods they produce most efficiently and buy goods that they produce less efficiently from other countries
  - even if this means buying goods from other countries that they could produce more efficiently at home

The Theory of Comparative Advantage

- Basic assumptions:
- 2 countries
- 2 products
- 1 factor of production (labour)
- Countries identical in all respect, but for differences in relative labour productivity
- Perfect competition in all markets
- Labour perfectly mobile across sectors within a country, but immobile internationally

How does the Theory of Comparative Advantage Work?

- Assume
  - Ghana is more efficient in the production of both cocoa and rice
  - in Ghana, it takes 10 resources to produce one ton of cocoa, and 13 1/3 resources to produce one ton of rice
  - So, Ghana could produce 20 tons of cocoa and no rice, 15 tons of rice and no cocoa, or some combination of the two
  - in South Korea, it takes 40 resources to produce one ton of cocoa and 20 resources to produce one ton of rice
  - so, South Korea could produce 5 tons of cocoa and no rice, 10 tons of rice and no cocoa, or some combination of the two

How Does The Theory Of Comparative Advantage Work?

- With trade
  - Ghana could export 4 tons of cocoa to South Korea in exchange for 4 tons of rice
  - Ghana will still have 11 tons of cocoa, and 4 additional tons of rice
  - South Korea still has 6 tons of rice and 4 tons of cocoa
  - if each country specializes in the production of the good in which it has a comparative advantage and trades for the other, both countries gain

How Does The Theory Of Comparative Advantage Work?

- Comparative advantage theory provides a strong rationale for encouraging free trade
  - total output is higher
  - both countries benefit
- Trade is a positive sum game

How Does The Theory Of Comparative Advantage Work?

Comparative Advantage and the Gains from Trade

Resources Required to Produce 1 Ton of Cocoa and Rice		
	Cocoa	Rice
Ghana	10	13.33
South Korea	40	20
Production and Consumption without Trade		
	Cocoa	Rice
Ghana	10.0	7.5
South Korea	2.5	5.0
Total production	12.5	12.5
Production with Specialization		
	Cocoa	Rice
Ghana	15.0	3.75
South Korea	0.0	10.0
Total production	15.0	13.75
Consumption After Ghana Trades 6 Tons of Cocoa for 6 Tons of South Korean Rice		
	Cocoa	Rice
Ghana	11.0	7.75
South Korea	4.0	6.0
Increase in Consumption as a Result of Specialization and Trade		
	Cocoa	Rice
Ghana	1.0	0.25
South Korea	1.5	1.0

Comparative advantage and the gains from trade

In this example, Ghana is more efficient in both productions.

Ghana has an **ABSOLUTE ADVANTAGE** in both C and R:

$$a_{LC} < a^*_{LC} \quad \text{and} \quad a_{LR} < a^*_{LR}$$

This implies that South Korea has an ABSOLUTE DISADVANTAGE in both C and R.

Comparative advantage and the gains from trade

..... but each country has a comparative advantage in something.

Ghana has a **COMPARATIVE ADVANTAGE** in Cocoa if:

$$(a_{LC}/a^*_{LC}) < (a_{LR}/a^*_{LR})$$

In fact, in this example:

$$(10/40) < (13{,}33/20)$$

Comparative advantage and the gains from trade

This, **by definition**, implies that:

- South Korea has a Comparative Advantage in R
- Ghana has a Comparative Disadvantage in R
- South Korea has a Comparative Disadvantage in C

Comparative advantage and the gains from trade: an alternative proof

Ricardo suggests that each country should produce and export the good in which it has a comparative advantage.

Following this strategy both country will gain from trade.

Comparative advantage and the gains from trade: an alternative proof

Let's proof this gains from trade result. The proof treats international trade as an alternative production process.

For Ghana the Ricardian suggestion is to stop producing domestically rice. Let's compare the two strategies to bring rice on the table of domestic consumers: A=autarky (no trade) and FT (free trade)

Comparative advantage and the gains from trade: an alternative proof

A: 1hL → (1/13,33) of R

FT: 1hL →(1/10) of C→int.mkt.(1C=1R) →(1/10) of R

FT "production system" is more efficient to produce Rice: (1/10) > (1/13,33)

Or, in other terms, Ghana gains from trade

Comparative advantage and the gains from trade: an alternative proof

For South Korea the Ricardian suggestion is to stop producing domestically Cocoa. Let's compare the two strategies to bring cocoa on the table of domestic consumers:

Comparative advantage and the gains from trade: an alternative proof

A: 1hL → (1/40) of C

FT: 1hL → (1/20) of R → int.mkt.(1C=1R) → → (1/20) of C

FT "production system" is more efficient to produce Cocoa: (1/20) > (1/40)

Or, in other terms, South Korea gains from trade

Is Unrestricted Free Trade Always Beneficial?

- Unrestricted free trade is beneficial, but the gains may not be as great as the simple model of comparative advantage would suggest
  - immobile resources
  - diminishing returns
  - dynamic effects and economic growth
  - the Samuelson critique
- But, opening a country to trade could increase
  - a country's stock of resources as increased supplies become available from abroad
  - the efficiency of resource utilization and so free up resources for other uses
  - economic growth

Could A Rich Country Be Worse Off With Free Trade?

- Paul Samuelson - the dynamic gains from trade may not always be beneficial
  - free trade may ultimately result in lower wages in the rich country
- The ability to offshore services jobs that were traditionally not internationally mobile may have the effect of a mass inward migration into the United States, where wages would then fall
  - but, protectionist measures could create a more harmful situation than free trade

What Is The Heckscher-Ohlin Theory?

- Eli Heckscher (1919) and Bertil Ohlin (1933) - comparative advantage arises from differences in national factor endowments
  - the extent to which a country is endowed with resources like land, labor, and capital
- The more abundant a factor, the lower its cost

Heckscher - Ohlin model

- In this model same hps. as in Ricardian model, but for:

- Existence of 2 factors of productions (K and L)
- Countries differ in terms of relative factor endowment

Some *definitions*:

A country (the US) is **relatively abundant** in capital (K) if:

$$(K/L)_{USA} > (K/L)_{RW}$$

Heckscher - Ohlin model

The production of a good (1) is **capital intensive** if:

$$K_1/L_1 > K_2/L_2$$

where K_1 is the amount of capital utilized to produce good 1 etc.

Heckscher – Ohlin (H-O) theorem

One major result within this model is the so-called **Heckscher-Ohlin Theorem**:

each country should export the good whose production is intensive in the relative abundant factor (ie. the relatively capital abundant country should export the capital intensive good – vice versa for the other country).

By doing so both countries gain from trade

H-O theorem

- Differently from Ricardian model, here the patterns of trade are determined by differences in factor endowments - not productivity
- Remember, focus on relative advantage, not absolute advantage

Empirical evidence on H-O theorem

Wassily Leontief in 1953 tested HO predictions for the USA

According to him HO implies the following:

$(K/L)_{USA} > (K/L)_{RW} \rightarrow (K/L)^{EXP}_{US} > (K/L)^{IMP}_{US}$

He found that:

$(K/L)^{EXP}_{US} < (K/L)^{IMP}_{US}$

This result became famous as the **Leontief paradox!!**

Gains from trade for all?

We have seen that trade generates economic gains for the countries involved.

But anedoctical evidence shows us that during and after a process of trade liberalization there are losers.

Gains from trade for all?

Trade theory predicts this outcome. Within the HO model there is a result (known as the **Stolper-Samuelson Theorem**) stating that when we open up to trade in a country the relative abundant factor will gain and the relatively scarse one will lose.

Gains from trade for all?

For example, in trade between a rich country and a poor one, we can think that the former is relatively skilled labour abundant and the latter is unskilled labour abundant. The SS theorem predicts that as a consequence of trade liberalisation skilled workers will gain and unskilled workers will loose in the rich country (viceversa in the poor one).

Gains from trade for all?

The SS theorem doesn’t contradicts the HO theorem. The latter says that the country overall will gain from trade, the former says that the distribution of these gain is so uneven to generate some loosers.

The total gains of the gainers are bigger than the totall losses of the losers.

Gains from trade for all?

Empirical evidence has shown that the SS theorem prediction is only partially empirically correct (for a recent and simple presentation, see The Economist, 6 August 2016).

Trade and income distribution

- More recently economists (for ex. Autor, Dorn, Hanson – 2015) found that after the rise of China as a major player in international markets, it can be shown that international trade with China has generated income distribution effects in the US and contributed to the reduction in manufacturing employment.

Trade and income distribution

- However, trade with China is only one part, albeit relevant, of US international trade. A more comprehensive study by Feenstra et al. (2017) takes into account the global (all countries, all trade – manuf. and services) evolution of US international trade and shows that thanks to international trade total employment in the US has increased.

Gains from trade for all?

However, the fact that changes in the economic environment (opening to trade, in this case) generates gainers and losers is not new.

Think of technical change. Also innovations generate losers. Remember the Luddites during the British Industrial Revolution. Or, more recently, the impact of the technological revolution we are in. The next table shows the prediction for occupations with the largest job decline in the US.

Gains from trade for all?

A recent video by WTO

and a comment by Paul Krugman (WTO Public Forum, 8 October 2017)

	Employment		Change, 2014-24		Median annual wage, 2015[1]
	2014	2024	Number	Percent	
Total, all occupations	150'539,9	160'328,8	9'788,9	6,5	$36'200
Bookkeeping, accounting, and auditing clerks	1'760,3	1'611,5	-148,7	-8,4	$37'250
Cooks, fast food	524,4	444,0	-80,4	-15,3	$19'080
Postal service mail carriers	297,4	219,4	-78,1	-26,2	$58'280
Executive secretaries and executive administrative assistants	776,6	732,0	-44,6	-5,7	$53'370
Farmworkers and laborers, crop, nursery, and greenhouse	470,2	427,3	-42,9	-9,1	$19'770
Sewing machine operators	153,9	112,2	-41,7	-27,1	$22'550
Tellers	520,5	480,5	-40,0	-7,7	$26'410
Postal service mail sorters, processors, and processing machine operators	117,6	78,0	-39,7	-33,7	$56'740
Cutting, punching, and press machine setters, operators, and tenders, metal and plastic	192,2	152,7	-39,5	-20,6	$31'280
Switchboard operators, including answering service	112,4	75,4	-37,0	-32,9	$27'440
Molding, coremaking, and casting machine setters, operators, and tenders, metal and plastic	129,5	97,2	-32,3	-25,0	$29'340
Computer programmers	328,6	302,2	-26,5	-8,0	$79'530
Printing press operators	173,0	151,4	-21,6	-12,5	$35'240
Mail clerks and mail machine operators, except postal service	104,9	85,1	-19,8	-18,8	$28'570
Bill and account collectors	350,4	330,9	-19,6	-5,6	$34'440
Dishwashers	507,4	487,9	-19,5	-3,9	$19'340
First-line supervisors of production and operating workers	606,9	588,2	-18,7	-3,1	$56'340
Postal service clerks	69,6	51,3	-18,3	-26,2	$56'790
Farmers, ranchers, and other agricultural managers	929,8	911,7	-18,1	-1,9	$64'170
Extruding and drawing machine setters, operators, and tenders, metal and plastic	73,4	55,5	-17,9	-24,4	$33'120
Helpers--production workers	419,2	403,2	-16,1	-3,8	$23'960
Grinding, lapping, polishing, and buffing machine tool setters, operators, and tenders, metal and plastic	71,4	55,8	-15,7	-21,9	$32'840
Shipping, receiving, and traffic clerks	670,2	655,7	-14,5	-2,2	$30'450
Word processors and typists	90,7	76,5	-14,2	-15,7	$37'610
Insurance underwriters	103,4	91,6	-11,7	-11,4	$65'040
Computer operators	61,1	49,5	-11,6	-19,0	$40'420
Office machine operators, except computer	69,6	58,0	-11,5	-16,6	$29'010
Welding, soldering, and brazing machine setters, operators, and tenders	59,5	48,8	-10,7	-18,0	$36'150
Electrical and electronic equipment assemblers	207,2	197,0	-10,2	-4,9	$30'860
Tool and die makers	77,8	67,7	-10,1	-13,0	$50'290

Largest job decline in the US

Source: BLS 2016

What Is The Product Life Cycle Theory?

- The product life-cycle theory - as products mature both the location of sales and the optimal production location will change affecting the flow and direction of trade
  - proposed by Ray Vernon in the mid-1960s
    - At this time most of the world's new products were developed by U.S. firms and sold first in the U.S.

What Is The Product Life Cycle Theory?

- According to the product life-cycle theory
  - the size and wealth of the U.S. market gave U.S. firms a strong incentive to develop new products
  - initially, the product would be produced and sold in the U.S.
  - as demand grew in other developed countries, U.S. firms would begin to export
  - demand for the new product would grow in other advanced countries over time making it worthwhile for foreign producers to begin producing for their home markets

What Is The Product Life Cycle Theory?

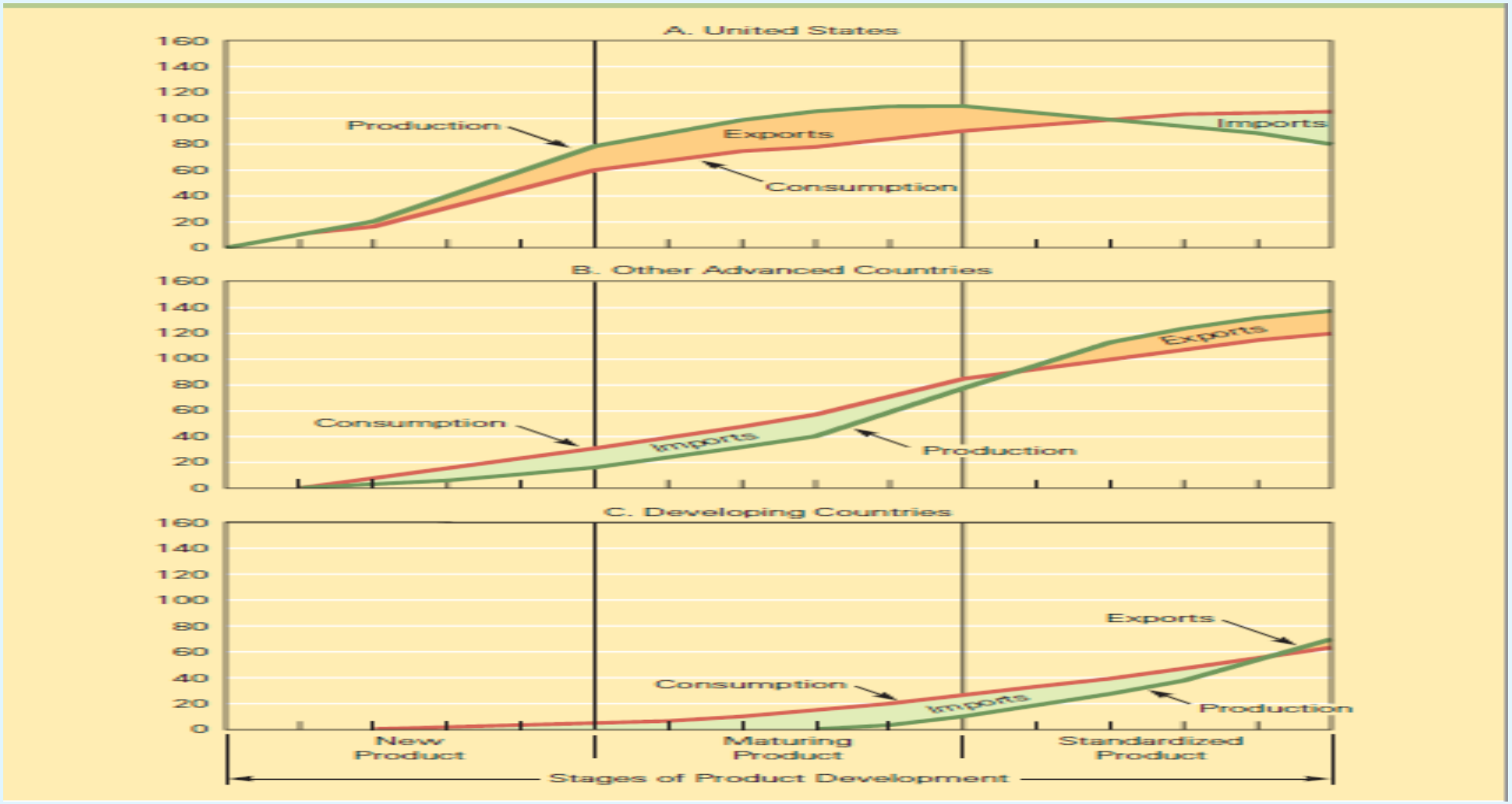
- U.S. firms might set up production facilities in advanced countries with growing demand, limiting exports from the U.S.
- As the market in the U.S. and other advanced nations matured, the product would become more standardized, and price would be the main competitive weapon

What Is The Product Life Cycle Theory?

- Producers based in advanced countries where labor costs were lower than the United States might now be able to export to the United States
- If cost pressures were intense, developing countries would acquire a production advantage over advanced countries
- Production became concentrated in lower-cost foreign locations, and the U.S. became an importer of the product

What Is The Product Life Cycle Theory?

The Product Life Cycle Theory



Does The Product Life Cycle Theory Hold?

- The product life cycle theory accurately explains what has happened for products like photocopiers and a number of other high technology products developed in the United States in the 1960s and 1970s
  - mature industries leave the U.S. for low cost assembly locations

Does The Product Life Cycle Theory Hold?

- But, the globalization and integration of the world economy has made this theory less valid today
  - the theory is ethnocentric
  - production today is dispersed globally
  - products today are introduced in multiple markets simultaneously

What Is New Trade Theory?

- New trade theory suggests that the ability of firms to gain economies of scale (unit cost reductions associated with a large scale of output) can have important implications for international trade
- Countries may specialize in the production and export of particular products because in certain industries, the world market can only support a limited number of firms
  - new trade theory emerged in the 1980s
  - Paul Krugman won the Nobel prize for his work in 2008

What Is New Trade Theory?

1. Through its impact on economies of scale, trade can increase the variety of goods available to consumers and decrease the average cost of those goods
   - without trade, nations might not be able to produce those products where economies of scale are important
   - with trade, markets are large enough to support the production necessary to achieve economies of scale
   - so, trade is mutually beneficial because it allows for the specialization of production, the realization of scale economies, and the production of a greater variety of products at lower prices

What Is New Trade Theory?

2. In those industries when output required to attain economies of scale represents a significant proportion of total world demand, the global market may only be able to support a small number of enterprises
   - first mover advantages - the economic and strategic advantages that accrue to early entrants into an industry
   - economies of scale
   - first movers can gain a scale based cost advantage that later entrants find difficult to match

New trade theory and intra-industry trade

- New trade theory explains trade in similar products (INTRA-INDUSTRY TRADE)
- Ricardian and H-O models were able to explain mainly trade in different products (INTER-INDUSTRY TRADE)

New trade theory and gains from trade

New trade theory highlights additional sources of gains from trade:

- **pro-competitive effect**: reduction in prices due to increased international competition
- **larger variety** of products available for the consumers

What Are The Implications Of New Trade Theory For Nations?

- Nations may benefit from trade even when they do not differ in resource endowments or technology
  - a country may dominate in the export of a good simply because it was lucky enough to have one or more firms among the first to produce that good
- Governments should consider strategic trade policies that nurture and protect firms and industries where first mover advantages and economies of scale are important

What Is Porter's Diamond Of Competitive Advantage?

- Michael Porter (1990) tried to explain why a nation achieves international success in a particular industry
  - identified four attributes that promote or impede the creation of competitive advantage

1. Factor endowments - a nation's position in factors of production necessary to compete in a given industry
   - can lead to competitive advantage
   - can be either basic (natural resources, climate, location) or advanced (skilled labor, infrastructure, technological know-how)

What Is Porter's Diamond Of Competitive Advantage?

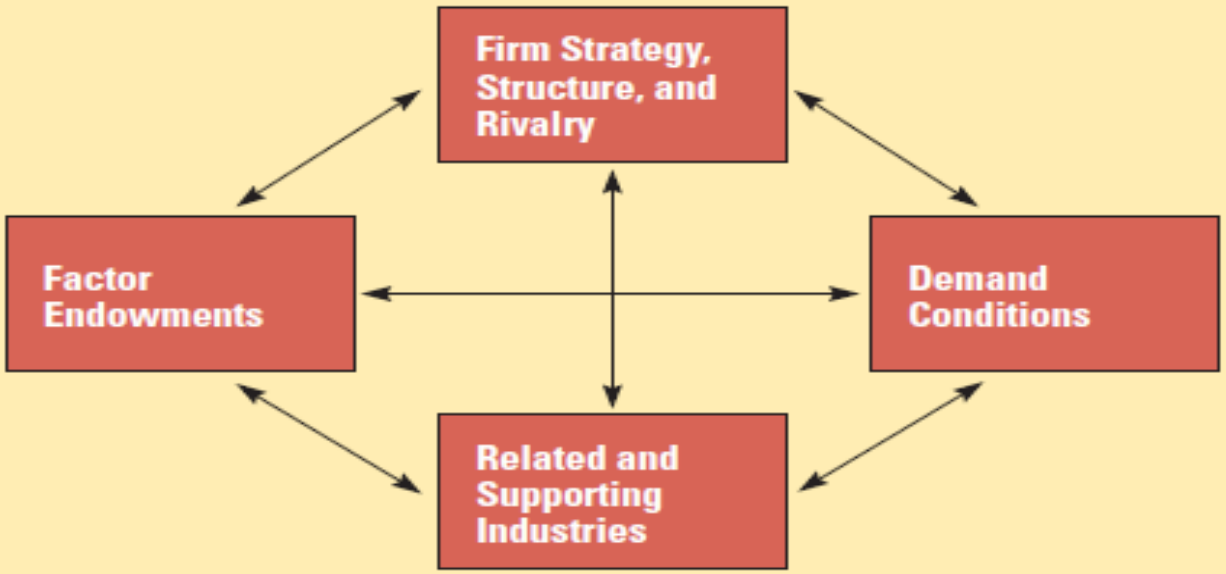
2. Demand conditions - the nature of home demand for the industry's product or service
   - influences the development of capabilities
   - sophisticated and demanding customers pressure firms to be competitive
3. Relating and supporting industries - the presence or absence of supplier industries and related industries that are internationally competitive
   - can spill over and contribute to other industries
   - successful industries tend to be grouped in clusters in countries

What Is Porter's Diamond Of Competitive Advantage?

4. Firm strategy, structure, and rivalry - the conditions governing how companies are created, organized, and managed, and the nature of domestic rivalry
   - different management ideologies affect the development of national competitive advantage
   - vigorous domestic rivalry creates pressures to innovate, to improve quality, to reduce costs, and to invest in upgrading advanced features

What Is Porter's Diamond Of Competitive Advantage?

Determinants of National Competitive Advantage: Porter's Diamond



Does Porter's Theory Hold?

- Government policy can
  - affect demand through product standards
  - influence rivalry through regulation and antitrust laws
  - impact the availability of highly educated workers and advanced transportation infrastructure.
- The four attributes, government policy, and chance work as a reinforcing system, complementing each other and in combination creating the conditions appropriate for competitive advantage
- So far, Porter's theory has not been sufficiently tested to know how well it holds up

Application of Porter's ideas

Porter's ideas have been applied to generate measures of country competitiveness. When applied to firm the concept of competitiveness is straightforward.

Attention when you use it for a country (differently form a firm a country cannot go bankrupt).

In this case the correct approach is to think of competitiveness as the set of conditions that favour economic growth.

In the last 10 years a proper industry has emerged to measure competitiveness at the country level.

The two most famous indices are those contained in the Global Competitiveness Report by the World Economic Forum (WEF) and The World Competitiveness Yearbook by IMD.

Application of Porter's ideas

I concentrate on the WEF production (choice independent of any value judgement!).

This year ranking (or in a map) :

Global Competitiveness Report 2017-2018

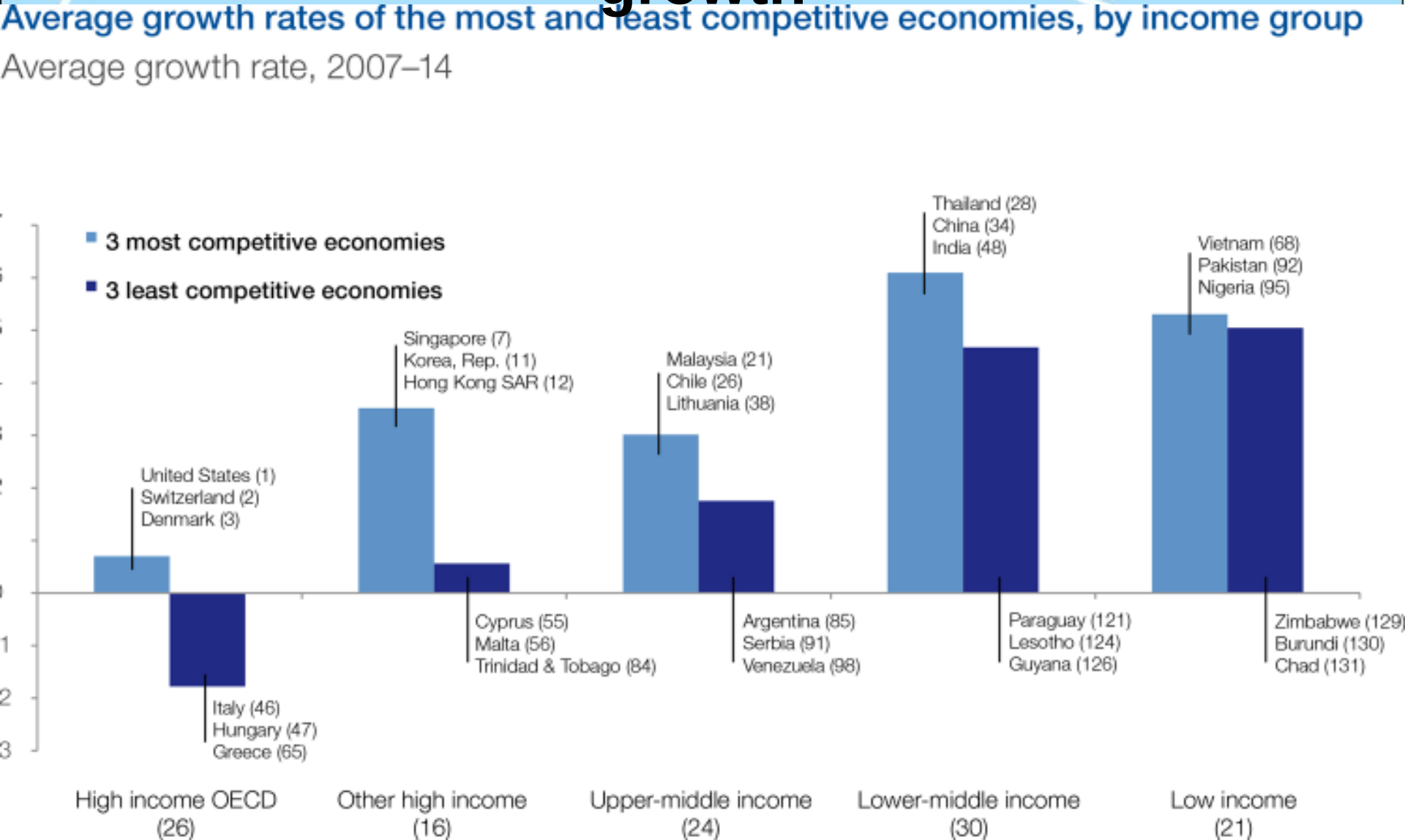
France profile

The Top 10 Most Competitive Global Economies

Global Competitiveness Report 2017-2018	Global rank*
Switzerland	1
United States	2
Singapore	3
Netherlands	4
Germany	5
Hong Kong SAR	6
Sweden	7
United Kingdom	8
Japan	9
Finland	10

Source: The Global Competitiveness Report 2017-2018
*2017-2018 rank out of 137 economies

More competitive countries by income group: "competitiveness" matters for economic growth



Application of Porter's ideas

In the report they generate a country ranking based on the **Global Competitiveness Index**

This index is a weighted average of other indices, which are themselves weighted averages of publicly available hard data and information provided in the Forum's Executive Opinion Survey.

Application of Porter's ideas

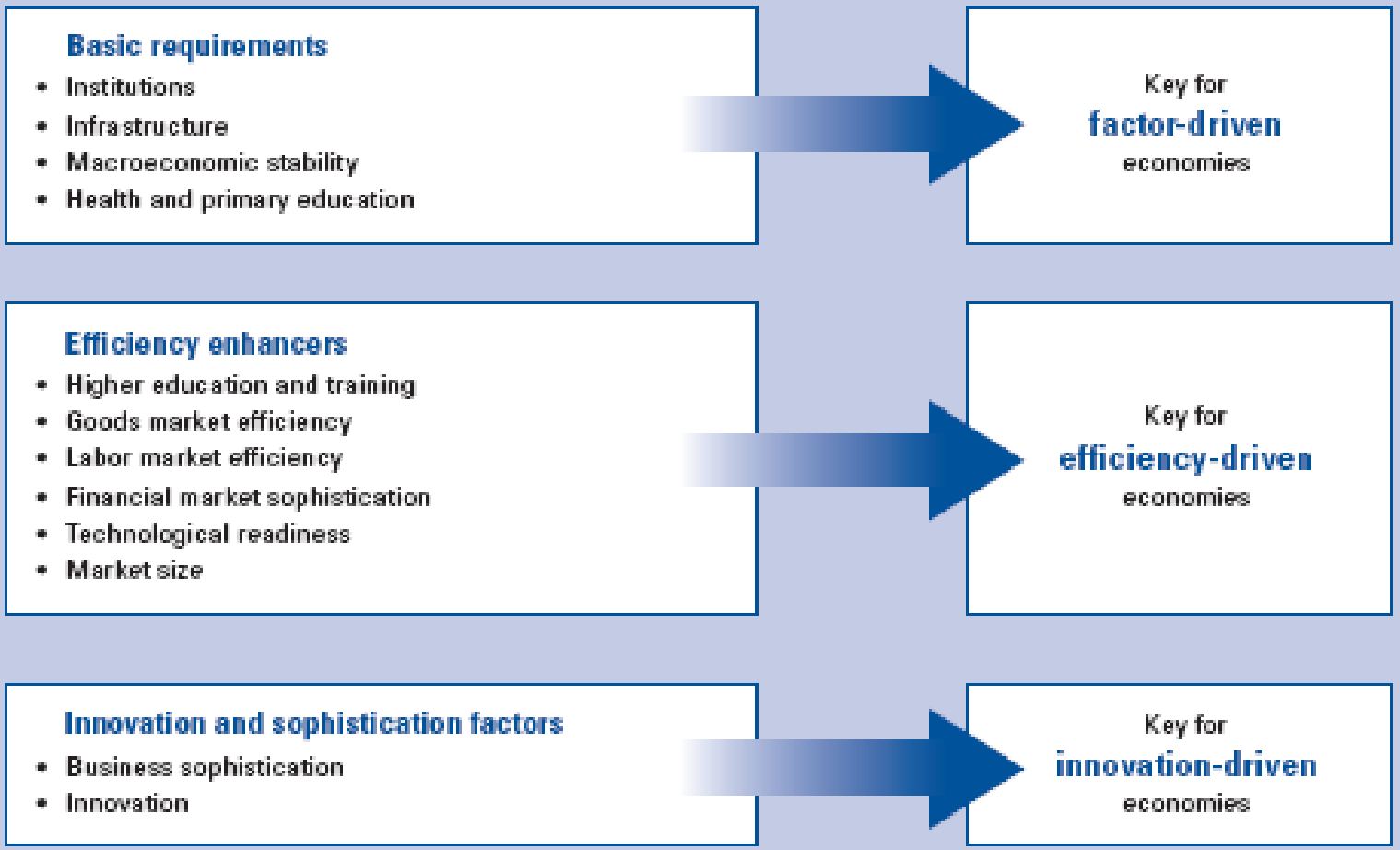
The **Global Competitiveness Index** is intended to measure factors that contribute to driving productivity and competitiveness.

It is composed by *12 basic pillars*

(i.e. 12 subsets of economic variables)

Application of Porter's ideas

Figure 1: The 12 pillars of competitiveness



What Are The Implications Of Trade Theory For Managers?

1. Location implications - a firm should disperse its various productive activities to those countries where they can be performed most efficiently
   - firms that do not may be at a competitive disadvantage
2. First-mover implications - a first-mover advantage can help a firm dominate global trade in that product
3. Policy implications - firms should work to encourage governmental policies that support free trade
   - want policies that have a favorable impact on each component of the diamond

What Is The Balance Of Payments?

- A country's balance of payments accounts keep track of the payments to and receipts from other countries for a particular time period
  - double entry bookkeeping
  - sum of the current account balance, the capital account and the financial account should be zero

What Is The Balance Of Payments?

- There are three main accounts

1. The current account records transactions of goods, services, and income, receipts and payments
   - current account deficit - a country imports more than it exports
   - current account surplus – a country exports more than it imports
2. The capital account records one time changes in the stock of assets
3. The financial account records transactions that involve the purchase or sale of assets
   - net change in U.S. assets owned abroad
   - foreign owned assets in the U.S.

What Is The Balance Of Payments?

United States Balance of Payments Accounts, 2010

Current Account	$ Millions
Exports of Goods, Services, and Income Receipts	2,159,233
Goods	1,068,499
Services	502,298
Income Receipts	588,203
Imports of Goods, Services, and Income Payments	–2,412,489
Goods	–1,945,705
Services	–1,575,443
Income Payments	–466,783
Unilateral Current Transfers (net)	–124,943
Current Account Balance	–378,432
CAPITAL ACCOUNT	
Capital Account Transactions (net)	–140
FINANCIAL ACCOUNT	
U.S.-Owned Assets Abroad, net	–140,465
U.S. Official Reserve Assets	–52,256
U.S. Government Assets	–541,342
U.S. Private Assets	–629,552
Foreign-Owned Assets in the United States	305,736
Foreign Official Assets in the United States	450,030
Other Foreign Assets in the United States	–144,294
Statistical Discrepancy	162,497

Is A Current Account Deficit Bad?

- Question: Does current account deficit in the United States matter?
- A current account deficit implies a net debtor
  - so, a persistent deficit could limit future economic growth
- But, even though capital is flowing out of the U.S. as payments to foreigners, much of it flows back in as investments in assets
- Yet, suppose foreigners stop buying U.S. assets and sell their dollars for another currency
  - a dollar crisis could occur