

## TRADE, INVESTMENT & THE CURRENT ACCOUNT:

$$\text{IMPORTS} = \text{EXPORTS} + \text{NET FOREIGN INVESTMENT}$$

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“Free markets and open trade are the best weapons against poverty, disease and tyranny.”

President George W. Bush

Critics are once again questioning the size and sustainability of the U.S. current account deficit. However, it is clear from the evidence that the U.S. current account deficit reflects a surplus of good investment opportunities in the U.S. and a deficit of growth prospects elsewhere in the world. This situation does not warrant a change in U.S. economic policy, nor would such a change in policy be welcome by the rest of the world.

As a matter of national income accounting, the current account is, by definition, the difference between national saving and investment, and is equal to the net accumulation of U.S. assets (portfolio and direct investments) by foreigners. The information provided by the current account balance itself is limited. A deficit is not necessarily bad, nor is a surplus necessarily good. This is because the U.S. is well integrated into the global capital market. It can finance its current account deficit in this capital market by selling equities, private debts, and government bonds — all denominated in dollars — without having to draw down international reserves or to incur foreign currency obligations.

The best way to interpret the present U.S. current account deficit is as follows: **Because of relatively good prospects for growth in the United States compared to the rest of the world, international capital is flowing to the U.S. in search of the safety and acceptable returns offered here.** Portfolio capital is not flowing to emerging markets as in the mid-1990s. Europe faces long standing structural challenges (high average unemployment, sluggish growth) that have not gone away despite the successful launch of the Euro. Japan is entering its second decade of economic contraction and continuing fiscal and financial difficulties. Not surprisingly in this setting, capital is flowing into the U.S. because of the relatively superior past performance and expectations for future growth in the U.S. economy.

**Trade Deficit and Net Foreign Investment  
as a Share of GDP**

