

The financing of the current account balance of the United States, 2000-2011

PADILLA- Felipe*† & HERNÁNDEZ- Guadalupe

Universidad Autonoma Metropolitana, San Pablo Xalpa 180, Reynosa Tamaulipas, Azcapotzalco, 02200 Mexico City, Federal District.

Instituto Politecnico Nacional, Plan de Agua Prieta 66, Professional Unit Lazaro Cardenas, Col. Plutarco Elias Calles, Miguel Hidalgo, CP 11350, Mexico, Federal District.

Received April 04, 2012; Accepted December 13, 2012

The objective of this study is to analyze the sources of funds for the balance of current account in the United States in the period 2000-2011. The theoretical framework is based on an economy open according to Samuelson. The result is that the sources of financing of the current account balance are: the balance of financial account, surplus savings countries such as China, Japan, United Kingdom and the oil exporting countries, which picked up through the bonds of the United States treasure. Also other sources of external financing are central banks and other official agencies foreign, as well as other capital flows such as: deposits, loans to the Government or the private business sector, or the purchase of shares, movable property or financial instruments with mortgage bonds.

Balance of current account surplus of external savings, Treasury bonds.

Citation: Padilla- F, Hernández- G. The financing of the current account balance of the United States, 2000-2011. ECORFAN Journal-Mexico 2012,3-8: 652-658

*Correspondence to Author (email: fpa@correo.azc.uam.mx)

† Researcher contributing first author.

Introduction

The economy of the United States has three decades with deficit in the balance of current account.

In 2000 the deficit stood at -416, 339 millions of dollars, increasing gradually to reach in 2006 the figure of -800, 621 millions of dollars. In 2007 decreased to -710, 304 millions of dollars and then -376, 551 millions of dollars in 2009 and finally -473, 441 millions of dollars in 2011.

This behavior is due to an increase in investment and household consumption.

Hence the interest of this work in determine the sources the financing the deficit in the balance of current account in the period 2000-2011.

This is part of a theoretical framework based on an open economy as Samuelson in establishing that the deficit in the current account balance is due to an excess of investment over savings or failure of the latter.

According to analysis of the percentage of savings and investment with respect to GDP of the United States the percentage of investment is always greater than the savings.

After establishing the theoretical framework analyzes the different sources of financing of the current account balance. Finally, conclusions are presented.

One is that one of the sources of financing of the United States is the external savings surplus countries like China, Japan, United Kingdom, oil exporting countries and other countries, which is obtained by placing bonds of the United States in these countries.

Theoretical Framework

In an open economy like the U.S. current account balance is defined as the difference between exports and imports.

The current account balance has more items (net income, transfers abroad) but with less weight in the total accounting, being the most significant trade balance.

According to Samuelson (2006) if we start from the accounting identity:

$$Y = C + I + G + XN \quad (1)$$

Where:

Y = national income

C = Consumption

I = Investment

G = Government Spending

NX = Net Exports

Passing consumption and government spending right side of the equation (1), the following equation results:

$$Y - C - G = I + XN \quad (2)$$

$$\text{Where } Y - C - G = S \quad (3)$$

Substituting for S (save) the term $Y - C - G$ we have:

$$S = I + XN \quad (4)$$

Equation 4 indicates that in equilibrium national saving equals investment plus net exports. Rewriting equation (4) we have:

$$S - I = XN \quad (5)$$

Sources of financing the current account balance

According to equation (5) a deficit in the current account balance is due to an excess of investment over savings, or insufficient savings relative to investment.

Figure 1 shows that since 1997 in the U.S. investment is greater than the saving. In the period 1997-2004 the percentage of saving to GDP is 16, while the investment is 20%.

These figures drop from 2006, reaching the saving 15% in 2007, while investment continues at 20%. In 2009, the saving is 12% and 17% the investment.

While in 2010 the saving is placed in 11% and investment in 15%. However, always is maintained the trend that the share of investment to GDP is greater than the saving.



Figure 1

Carranza (1997) affirms that considering the current account balance as the difference between saving and investment.

Result a deficit as consequence of a higher rate of investment this causes increased growth and greater solvency, otherwise, if a rate of saving descend which causes the deficit it originates external passive accumulation that doesn't causes output growth, and the country's solvency deteriorates.

Generally when imports are greater than exports this is a problem of competitiveness.

However in the case of the United States investment is greater than saving implying that is a productive economy is growing (Atish, 2006).

According dates of the World Economic Forum 2009, the competitiveness of the United States passed first place to second, the first place to Switzerland and the second to the United States.

The level of competitiveness of the United States continues to decline from second place in 2009 to fifth in 2011.

However, the weakness of the United States is at the level of macroeconomic stability, in 2008 held the place 63 and in 2009 the 93.

Given that the United States has negative net exports they have to be financed by net foreign investment which "represent the net savings of the United States in the abroad" (Samuelson, 2006: 595).

These negative net exports mean that net foreign investment was negative so the United States debt increases in the abroad.

This represents an accumulation of obligations of the United States to the rest of the world that have to finance through of the financial account balance, at a certain point have to pay (Atish, 2006).

Consistent with this idea, Bernanke (2005) argues that the deficit of the current account balance is financed by an excess global saving.

However, many advanced economies have slow growth and shortage of labor and few unlikely of national investment. So when there is a persistent deficit in the current account balance is convenient to analyze how much will pay the debt and whether if the loans generate an investment with a marginal productivity higher than the interest rate charged by foreign creditors to have the necessary solvency to pay debts that contract.

As is mentioned to finance the current account balance must capture the equivalent of foreign savings that exists in international markets, they have to take global saving surplus (Higgins, 2007: 2).

Thus, the current account deficit of the United States has its counterpart in the surplus of China, Japan and Germany as well as in oil-exporting countries due to high oil prices that occurred in the past decade.

These countries exported the 52.6% of total capital flows in 2008, of which the United States attracted 43% of such flows. The issuance of treasury bonds of the United States was the primary means to capture these flows.

In Figure 2 shows that the placement of treasury bonds have increased substantially moving from 100,000 millions of dollars in 2007 to 530,000 millions of dollars in 2008 and then to 550,000 millions of dollars in 2009 and after in 400,000 millions of dollars in 2010.

These figures reflect that these investments have increased by more than 4 times compared with 2007.

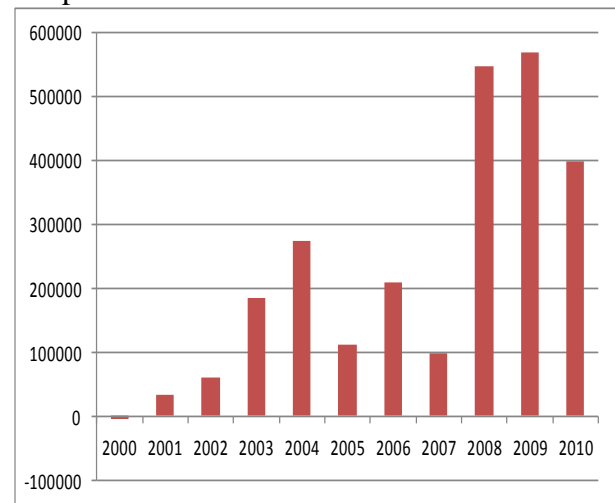


Figure 2

Also in Figure 3 shows that a major foreign bondholders in April 2009 is China with 1,190 millions of dollars, followed by Japan and the UK with 900 and 300 million dollars.

The oil exporting countries and other countries are in 200 billion of dollars.

Another source of external funding for the United States are central banks and others foreign government agencies. In 2006 it was the most important source of funding for the country.

The capital flows come in various ways such as: bank deposits, loans to the government or the private business sector, or the purchase of shares, movables assets and financial instruments with mortgage bonds (Fernandez, 2007).

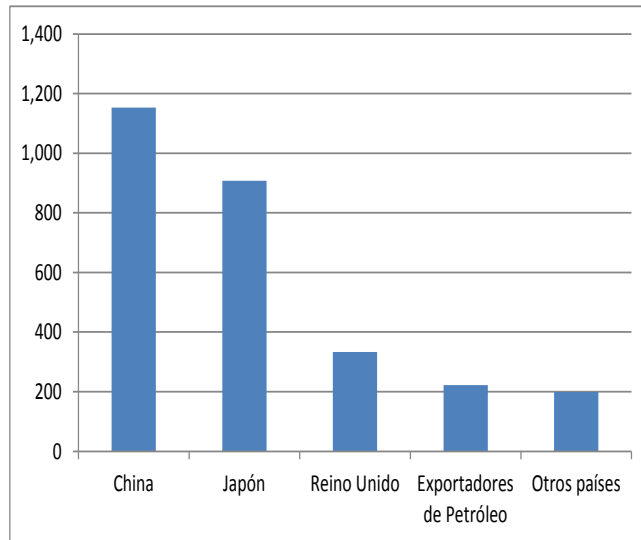


Figure 3

The financiarización of the U.S. economy has allowed to the United States have a greater capture of financial mass that moves in international markets.

Obtaining thus their growth. In addition the United States has an advantage over its debt, because the United States investments in the abroad are more profitable than foreign investments in the United States (Cobarrubias, 2009).

The hegemony of the dollar has helped to the United States to finance its deficit of current account through the entry of foreign capital.

This means that even if the deficit of current account increases, the overvaluation of the dollar may encourage foreign capital inflows.

However there is a risk, if the deficit of current account is continue, the country acquire debt every year with year and if the creditors do not want to finance the current account balance it becomes in a problem and the economy may be in crisis.

If the debt is short term, there is a problem, the creditors can demand now loans that financed the current account balance from previous years (Stiglitz, 2002).

Nevertheless, some very important, is that the income balance has a surplus.

Although the United States show a debit with the exterior, the assets of the United States in the abroad have a higher return than the cost of its liabilities.

Which help moderate the growth of its debt (Fernandez, 2007).

To respect in Figure 4 shows that external debt increased substantially since 2005 from 6,000 million to 14,000 million dollars in 2011, representing an annual average growth rate of 40.7%.

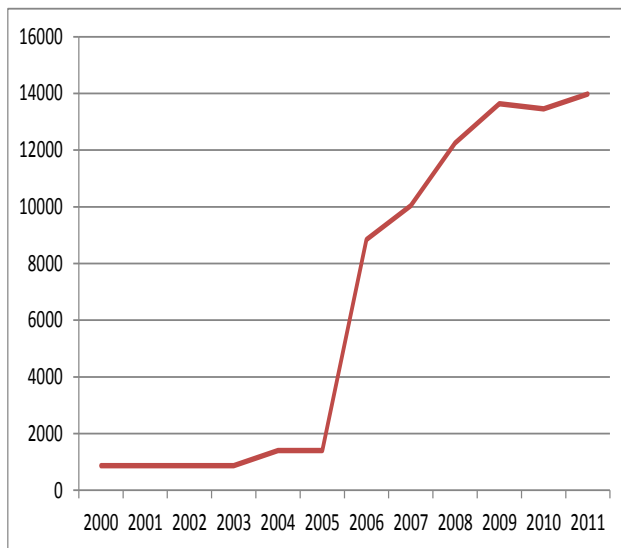


Figure 4

Conclusions

This article analyzes the sources of financing of the current account balance of the United States in the period 2000-2011.

To this end, part of a theoretical framework that is based on an open economy according Samuelson (2006) which establish that a deficit in the current account balance is due to over-investment relative to saving or failure of saving over investment.

For the United States the share of investment in GDP is always greater than the saving.

In the period 1997-2004 these percentages are 20% and 16% respectively.

While in 2007 are 20% and 15% and in 2010 15% and 11%, which means it is a growing productive economy.

However their competitiveness has declined. En 2009 held second place and in 2011 fifth.

The fact that investment is greater than saving means that net exports are negative, it implying that net foreign investment is negative and the accumulation of obligations of the United States with the rest of the world that have to finance through balance of financial account.

Another way to finance the deficit of the balance of current account is through saving surplus from developed countries like China, Japan and Germany and the oil-exporting countries and other countries.

This surplus is captured through the placement of treasury bonds of the United States, which grew substantially from 2008 recorded a figure of 530,000, 570,000 and finally 400, 000 million of dollars in 2008, 2009 and 2010, respectively.

Also other sources of external financing are central banks and other foreign government agencies and other capital flows such as: bank deposits, loans to the government or the private business sector, or the purchase of shares, movables assets with bonds mortgage.

Other factors that contribute to attracting external resources are the financiarización of the United States, which has allowed have a greater capture of financial mass in international markets.

In addition the United States has an advantage over their debt the investments in the abroad are more profitable than foreign investments in the United States.

The overvaluation of the dollar also has financed its deficit of current account by foreign capital inflows.

References

- Aguado, Sebastian Saturnino (2008), "The U.S. Economy: The Return of the deficits", *Journal of World Economics* 019.
- Carranza, L. (1997), The sustainability of the current account online.
- Beams, Nick, (2000) Deficit The U.S. Commercial Beat Monthly Record; Indicates Deep Economically, World Socialist Web Site, published by the International Committee of the Fourth International (ICFI), October.
- Bernanke, Ben S. (2005), The global saving glut and the glut and the U.S. current account deficit, Sandrige Conference lecture, Virginia Association of economists, Richmond Virginia, St Louis, Missouri.
- Cobarrubias, Katia Hernandez, (2009), the United States in the international monetary and financial order. Tensions and reversals during the administration of George W. Double Bush, Center for Hemispheric and United States, University of Havana, October, p. 1-20.
- Spanish, (2009), U.S. loses top spot in global competitiveness list, according to the World Economic Forum, September 9, accessed on Friday, August 10.
- Fernández, Enric (2007), The sustainability of the U.S. external deficit, in documents of economy "Caixa", Barcelona, April, No. 5, p. 1-25.
- Ghosh, Atish and Uma Ramakrishnan (2006), Does it matter the current account deficit? in *Finance and Development*, December. pp. 44-45
- Hakkio, By Craig S. (1995), The U.S.: Current Account: The other deficit, Third Quarter Economic review, Federal Reserve Bank of Kansas City.
- Hernandez, Carmen Guadalupe and Felipe de Jesús Aguilar Padilla, (2012), the twin deficits of the United States, a comparison of two periods (1981-1988, 2001-2008), *Journal ECORFAN (Finance)*, vol. 3 no. 6, 85-100.
- Krugman, Paul R. and Maurice Obstfeld, (2006), *International Economics Theory and policy*, trad. Yago Moreno, Addison Wesley Pearson, 7th ed., Spain, pp.746.
- Higgins, Thomas Klitgaard and Matew, (2007), *Financial Globalization and the U.S. Current Account Deficit in Current Issues in Economics and Finance*, Federal Reserve Bank New York, December., Vol. 13, no. 11, pp. 1-7.
- Samuelson, Paul A. and William D. Nordhaus, (2006), *Economics*, Trad. Maria Guadalupe Cevallos Almada et al, McGraw-Hill, 8a. ed., Mexico, pp. 758.
- Stiglitz, Joseph, (2010), *Globalization and its Discontents*, trans. Carlos Rodriguez Brown, bookmark, Mexico, pp. 448.
- World Economic Forum (2011), *The Global Competitiveness Report 2011-2012*, Geneva, Switzerland.