Investment and the Trade Balance

Net Foreign Investment and the Trade Deficit (As % of GDP), 1980-2000

Which is the Chicken and Which is the Egg?

Previous explanations talk about the investment as a way of covering our spending. Maybe it is the other way around.

(d) Investment Opportunities

\[ D = I - S + (G-T) + X - M \]

This is the place to invest because the economy is good.
An Analogy

- You discover an undeveloped Caribbean island with resort potential. You persuade the locals to exploit it.
- Huge investments in hotels, roads, and infrastructure are required.
- A huge negative balance on capital account.

Is this bad? Obviously not.

Evidence

- Does the trade balance track saving?

No
Evidence

- Does the trade balance track saving? No
- Does the trade balance track government deficits? No
- Does the trade balance track investment opportunities? Yes

19th Century Trade Balances

- In the last part of the 19th century, the United States ran a substantial current account deficit, financed substantially by the British.

Trade and Investment

- 19th Century Trade Balances
- Post World War II
- The Business Cycle
- International Comparisons
19th Century Trade Balances

• In the last part of the 19th century, the United States ran a substantial current account deficit, financed substantially by the British.
• There were significant investment opportunities in this rapidly growing economy.

Trade after World War II

• At the end of WW II, the United States ran a significant current account surplus, for exactly the same reason. The War devastated Europe, and investment opportunities there were highly profitable.

Balance on Current Account

When times are good, there are investment opportunities and the trade balance is bad.
Trade Deficits and Business Cycles

G-7 Experience

Don’t invest in slow growing countries

End

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