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Financing the U.S. Trade Deficit

Updated February 10, 2017

Congressional Research Service
https://crsreports.congress.gov
RL33274

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

The U.S. merchandise trade deficit is a part of the overall U.S. balance of payments, a summary statement of all economic transactions between the residents of the United States and the rest of the world, during a given period of time. Some Members of Congress and other observers have grown concerned over the magnitude of the U.S. merchandise trade deficit and the associated increase in U.S. dollar-denominated assets owned by foreigners. International trade recovered from the global financial crisis of 2008-2009 and the subsequent slowdown in global economic activity that reduced global trade flows and, consequently, reduced the size of the U.S. trade deficit. Now, however, U.S. exporters face new challenges with an increase in the international exchange value of the dollar relative to other key currencies and the slow rate of economic growth in important export markets in Europe and Asia. This report provides an overview of the U.S. balance of payments, an explanation of the broader role of capital flows in the U.S. economy, an explanation of how the country finances its trade deficit or a trade surplus, and the implications for Congress and the country of the large inflows of capital from abroad. The major observations indicate the following.

- The current account balance, the broadest measure of U.S. trade in goods, services, and certain income flows, worsened by 18% in 2015 from that recorded in 2014. Foreign-owned assets in the United States continued to outpace U.S. ownership of foreign assets, reflecting the deficit in the current account, but the net amount, or the difference between U.S.-acquisition of foreign assets and foreign acquisition of U.S. assets, dropped by about one-third in 2015 compared with 2014 and down by over half since 2012. The relative decline in foreign acquisitions of U.S. assets in 2015 reflected a drop in the net private purchases of U.S. corporate stocks and a decline by one-third in net private purchases of U.S. treasury securities. In addition, foreign official purchases of U.S. portfolio purchases shifted from positive net purchases in 2014 to negative net purchases in 2015, including a 38% decline in purchases of corporate stocks and a 58% decline in official purchases of U.S. Treasury securities. Foreign private net purchases of U.S. Treasury securities in 2015 fell by one-third from those in 2014, but foreign private purchases of U.S. equities increased by 20% in 2015 compared with 2014. At the same time, foreign direct investment increased by 83% in 2015 compared with 2014, rising from $207 billion in 2014 to $379 billion in 2015; U.S. direct investment abroad in 2015 rose slightly above the amount invested in 2014, although U.S. net purchases of foreign equities and debt securities in 2015 fell by 75%, compared with net purchases in 2014. The inflow of capital from abroad supplements domestic sources of capital and likely allows the United States to maintain its current level of economic activity at interest rates that are below the level they likely would be without the capital inflows.
- Foreign official and private acquisitions of dollar-denominated assets likely will generate a stream of returns to overseas investors that would have stayed in the U.S. economy and supplemented other domestic sources of capital had the assets not been acquired by foreign investors. In general terms, foreign private holders of U.S. Treasury securities are taxed on their interest income, depending on U.S. tax conventions with other countries.

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Background

By standard convention, the balance of payments accounts are based on a double-entry bookkeeping system. As a result, each transaction entered as a credit must have a corresponding debit and vice versa. This means that a surplus or deficit in one part of the accounts necessarily will be offset by a deficit or surplus, respectively, in another account so that, overall, the accounts are in balance. This convention also means that a deficit in one account, such as the merchandise trade account, is not necessarily the same as a debt.[1] The trade deficit can become a debt equivalent depending on how the deficit is financed and the expectations of those who hold the offsetting dollar-denominated U.S. assets. The balance of payments accounts are divided into three main sections: the current account, which includes the exports and imports of goods and services and personal and government transfer payments; the capital account, which includes such capital transfers as international debt forgiveness; and the financial account, which includes official transactions in financial assets and private transactions in financial assets and direct investment in businesses and real estate. In these accounts, exports are recorded as a positive amount even though they represent an outflow of goods and services from the economy, because they represent a credit for which there is a specific obligation of repayment. Similarly, although imports represent an inflow of goods and services to the economy, they are recorded as a negative amount, because they represent a debt that must be repaid.

When the basic structure of the balance of payments was established, merchandise trade transactions dominated the accounts. Financial transactions recorded in the capital accounts generally reflected the payments and receipts of funds that corresponded to the importing and exporting of goods and services. As a result, the capital accounts generally represented "accommodating" transactions, or financial transactions associated directly with the buying and selling of goods and services. During this early period, exchange rates between currencies were fixed, and private capital flows, such as foreign investment, were heavily regulated so that nearly all international flows of funds were associated with merchandise trade transactions and with some limited government transactions.

Since the 1970s, however, private capital flows have grown markedly as countries have liberalized their rules governing overseas investing and as nations have adopted a system of floating exchange rates, where the rates are set by market forces. Floating exchange rates have spurred demand for the dollar. The dollar also is sought for investment purposes as it has become a vehicle itself for investment and speculation and it serves as a major trade invoicing currency. This means that the balance of payments records not only the accommodating flows of capital which correspond to imports and exports of goods and services, but also autonomous flows of capital that are induced by a broad range of economic factors that are unrelated directly to the trading of merchandise goods.

Capital Flows and the Dollar

Liberalized capital flows and floating exchange rates have greatly expanded the amount of autonomous capital flows between countries. These capital transactions are undertaken in response to commercial incentives or political considerations that are independent of the overall balance of payments or of particular accounts. As a result of these transactions, national economies have become more closely linked, the process some refer to as "globalization." The

[1] For additional information about the causes of the U.S. trade deficit, see CRS Report RL31032, *The U.S. Trade Deficit: Causes, Consequences, and Policy Options*, by Craig K. Elwell.

data in **Table 1** provide selected indicators of the relative sizes of the various capital markets in various countries and regions and the relative importance of international foreign exchange markets. In 2013, these markets amounted to over $900 trillion, or more than 50 times the size of the U.S. economy. Worldwide, foreign exchange and interest rate derivatives, which are the most widely used hedges against movements in currencies, were valued at $655 trillion in 2013, more than twice the size of the combined total of all public and private bonds, equities, and bank assets. For the United States, such derivatives total more than three times as much as all U.S. bonds, equities, and bank assets.

Table 1. Selected Indicators of the Size of the Global Capital Markets, 2013

(billions of dollars)

			Bonds, Equities, and Bank Assets				Exchange Market Derivatives		
	Gross Domestic Product (GDP)	Total Official Reserves	Total	Stock Market Capitalization	Debt Securities	Bank Assets	Total	OTC Foreign Exchange Derivatives	OTC Interest Rate Derivatives
World	$75,470.9	$12,127.7	$286,584.7	$62,552.0	$97,288.6	$126,744.1	$655,352	$70,553	$584,799
European Union	16,705.2	570.0	91,326.4	12,646.3	29,964.2	48,715.9	NA	NA	NA
Euro Area	13,109.7	331.0	66,100.7	7,539.2	22,461.4	36,100.2	266,845	25,177	241,668
United Kingdom	2,680.1	92.4	20,207.1	4,035.4	5,750.6	10,421.2	61,415	8,789	52,626
United States	16,768.1	133.5	72,695.5	22,280.7	34,494.3	15,920.5	234,401	61,019	173,382
Japan	4,919.6	1,237.2	28,359.7	4,599.3	12,260.7	11,499.7	66,673	14,122	52,551
Emerging markets	29,104.8	7,984.4	56,384.1	11,232.7	11,225.1	33,926.3	NA	NA	NA

Source: Global Financial Stability Report, International Monetary Fund, April 2015. Statistical Appendix, Table 1; *Quarterly Review*, Bank for International Settlements, March, 2015, Tables 20b and 21b.

Note: "Total derivatives" does not include equity and commodity-linked derivatives. April 2015 was the last time the IMF published these data.

Another aspect of capital mobility and capital inflows is the impact such capital flows have on the international exchange value of the dollar. Demand for U.S. assets, such as financial securities, translates into demand for the dollar, since U.S. securities are denominated in dollars. As demand for the dollar rises or falls according to overall demand for dollar-denominated assets, the value of the dollar changes. These exchange rate changes, in turn, have secondary effects on the prices of U.S. and foreign goods, which tend to alter the U.S. trade balance. At times, foreign governments intervene in international capital markets to acquire the dollar directly or to acquire Treasury securities in order to strengthen the value of the dollar against particular currencies. In addition, various central banks moved aggressively following the Asian financial crisis in the 1990s to bolster their holdings of dollars in order to use the dollars to support their currencies should the need arise.

The dollar is also heavily traded in financial markets around the globe and, at times, plays the role of a global currency. Disruptions in this role have important implications for the United States and for the smooth functioning of the international financial system. During the decade preceding the recent global financial crisis, banks and other financial institutions expanded their global

balance sheets from $10 trillion in 2000 to $34 trillion in 2007. These assets were comprised primarily of dollar-denominated claims on non-bank entities, including retail and corporate lending, loans to hedge funds, and holdings of structured finance products based on U.S. mortgages and other underlying assets. As the crisis unfolded, the short-term dollar funding markets served as a major conduit through which financial distress was transmitted across financial markets and national borders, according to analysts with the Bank for International Settlements (BIS).[2] When these short-term dollar funding markets collapsed in the early stages of the crises, the U.S. Federal Reserve engaged in extraordinary measures, including a vast system of currency swap arrangements with central banks around the world, to supply nearly $300 billion. After initially expanding the then-existing reciprocal currency arrangements (swap lines) with the European Central Bank, the Bank of England, the Swiss National Bank, and the Bank of Japan, the Federal Reserve made an unprecedented announcement in October 2008 that it would provide swap lines to "accommodate whatever quantity of U.S. dollar funding is necessary" to stem the dollar shortage.[3] At the same time, the U.S. Treasury announced a money market guarantee program to stop the withdrawal of funds from the money markets and to offset the withdrawals by providing public funds.

The prominent role of the dollar means that the exchange value of the dollar often acts as a mechanism for transmitting economic and political news and events across national borders. While such a role helps facilitate a broad range of international economic and financial activities, it also means that the dollar's exchange value can vary greatly on a daily or weekly basis as it is buffeted by international events. A triennial survey of the world's leading central banks conducted by the Bank for International Settlements in April 2016 indicates that the *daily* trading of foreign currencies through traditional foreign exchange markets[4] totaled $5.1 trillion, down 5% from the $5.3 trillion reported in the previous survey conducted in 2013, as indicated in **Figure 1**.[5] In addition to the traditional foreign exchange market, the over-the-counter (OTC)[6] foreign exchange derivatives market reported that daily turnover of interest rate and non-traditional foreign exchange derivatives contracts reached $2.7 trillion in April 2016.[7] The combined amount of nearly $8.0 trillion for daily foreign exchange trading in the traditional and OTC markets is more than four times the *annual* amount of U.S. exports of goods and services. The BIS data also indicate that 88.0% of the global foreign exchange turnover in April 2016 was in U.S. dollars, as indicated in **Figure 2**.[8] This share was slightly higher than the 87.0% share reported in a similar survey conducted in 2013.[9]

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[2] McGuire, Patrick, and Gotz von Peter, "The US Dollar Shortage in Global Banking and the International Policy Response," BIS Working Paper No. 291, the Bank For International Settlements, October 2009; McGuire, Patrick, and Goetz von Peter, "The U.S. Dollar Shortage in Global Banking," *BIS Quarterly Review*, March 2009.

[3] Ibid., p. 76.

[4] Traditional foreign exchange markets are organized exchanges which trade primarily in foreign exchange futures and options contracts where the terms and condition of the contracts are standardized.

[5] *Triennial Central Bank Survey, Foreign Exchange Turnover in April 2016*, Bank for International Settlements, September 2016, p. 9.

[6] The over-the-counter foreign exchange derivatives market is an informal market consisting of dealers who custom-tailor agreements to meet the specific needs regarding maturity, payments intervals, or other terms that allow the contracts to meet specific requirements for risk.

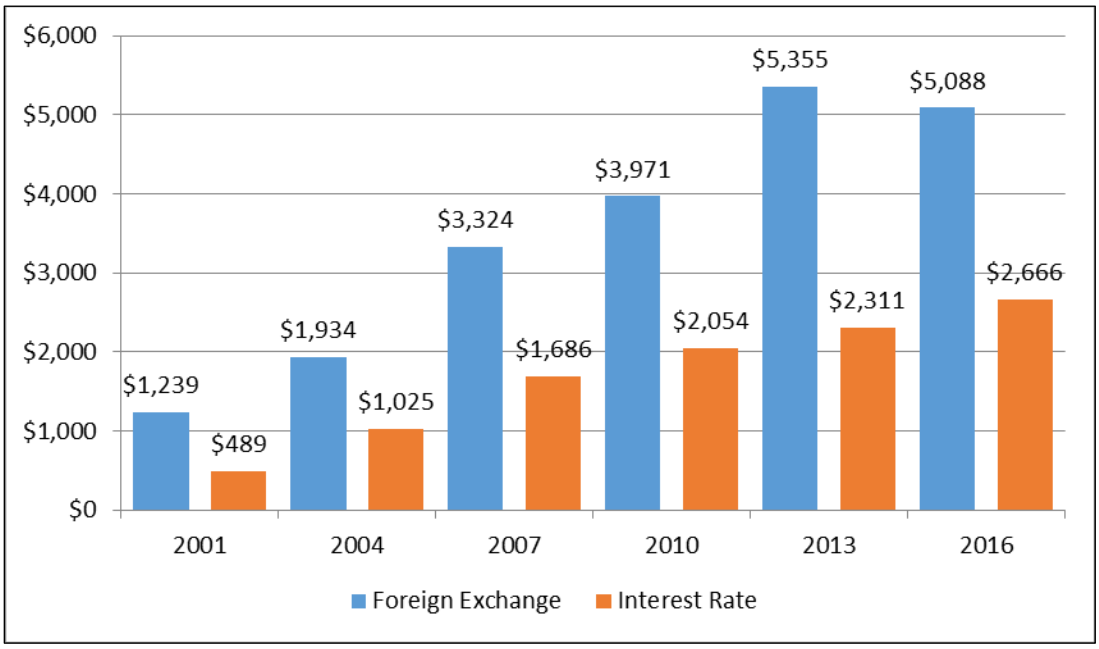
[7] *Triennial Central Bank Survey, OTC Interest Rate Derivatives Turnover in April 2016*, Bank for International Settlements, September 2016, p. 8.

[8] The percentage shares among all currencies add to 200, since two currencies are involved in each transaction.

[9] Rime, Dagfinn, and Andreas Schrimpf, The Anatomy of the Global FX Market Through the Lens of the 2013 Triennial Survey, *Quarterly Review*, Bank for International Settlements, December 2013.

Figure 1. Foreign Exchange and Interest Rate Derivatives Turnover in April of the Year Indicated

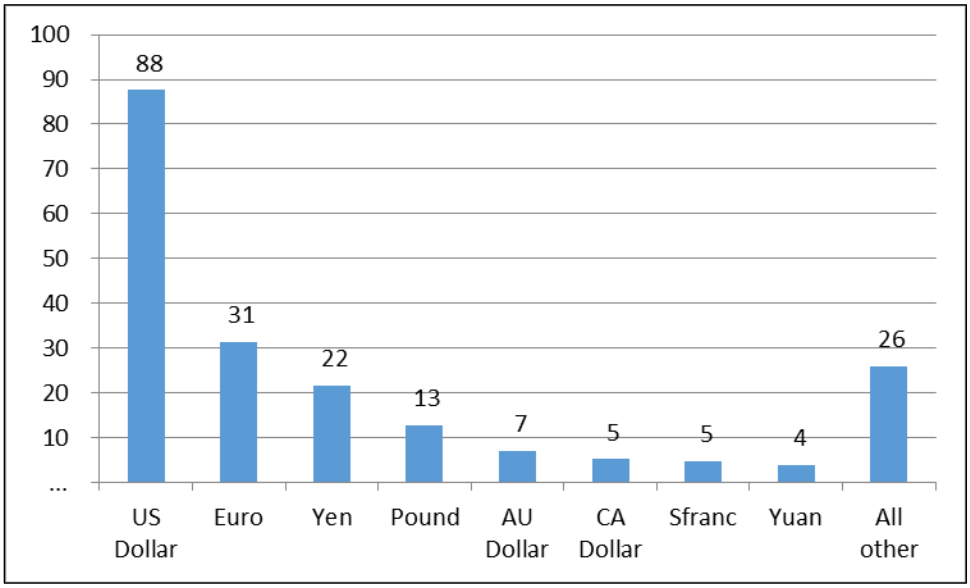
(billions of U.S. dollars)



Source: Bank for International Settlements.

Figure 2. Share of Foreign Exchange Turnover by Currency, April 2016

(percent shares)



Source: Bank for International Settlements.

The U.S. Balance of Payments

Table 2 presents a summary of the major accounts in the U.S. balance of payments over the four quarters of 2015 and the first two quarters of 2016. The data indicate that throughout the period, the U.S. current account, or the balance of exports and imports of goods, services and transfers, was in deficit, or the United States imported more goods and services than it exported. The current account balance represents the broadest measure of U.S. trade in goods, services, and certain income flows. The balance worsened by 16% from 2014 to 2015. On a quarterly basis, the deficit in the current account has varied from quarter to quarter, although remaining negative, reflecting a broad range of economic activities.

Most economists argue that, given the current composition of the U.S. economy, foreign capital inflows play an important role by bridging the gap between domestic supplies of and demand for capital, or between the total amount of saving in the economy relative to the total amount of investment. Indeed, economists generally argue that it is this interplay between the demand for and the supply of credit in the economy, rather than the flow of manufactured goods and services, that drives the broad inflows and outflows of capital and serves as the major factor in determining the international exchange value of the dollar and, therefore, the overall size of the nation's trade deficit or surplus. Capital inflows, in turn, place upward pressure on the dollar's exchange rate, pushing the exchange value of the dollar up relative to other currencies. As the dollar rises in value, the price of U.S. exports rises and the price of imports falls, which tends to increase the current account deficit.[10]

The important role capital flows play in determining the overall trade balance is demonstrated in the recent changes that have occurred in the price of oil and its impact on the U.S. trade deficit. Given the prominent role that energy imports play in the U.S. trade deficit, the U.S. trade deficit might be expected to decline along with the drop in the price of oil that occurred in 2014 and 2015, but this was not the case. From 2014 to 2015, the average price of an imported barrel of crude oil fell by nearly half from an average annual price of $91 per barrel to an average annual price of $47 per barrel, although the price of imported crude oil fell below $40 per barrel by the end of 2015. At the same time that the average price in imported crude oil dropped sharply, the quantity of imported crude oil fell by 1.4%. As a result of this drop in crude oil prices and relatively stable quantity of imports, crude oil imports fell from accounting for more than 40% on average of the annual U.S. merchandise trade deficit in 2012 to about 10% on average of the annual U.S. trade deficit in 2015.[11]

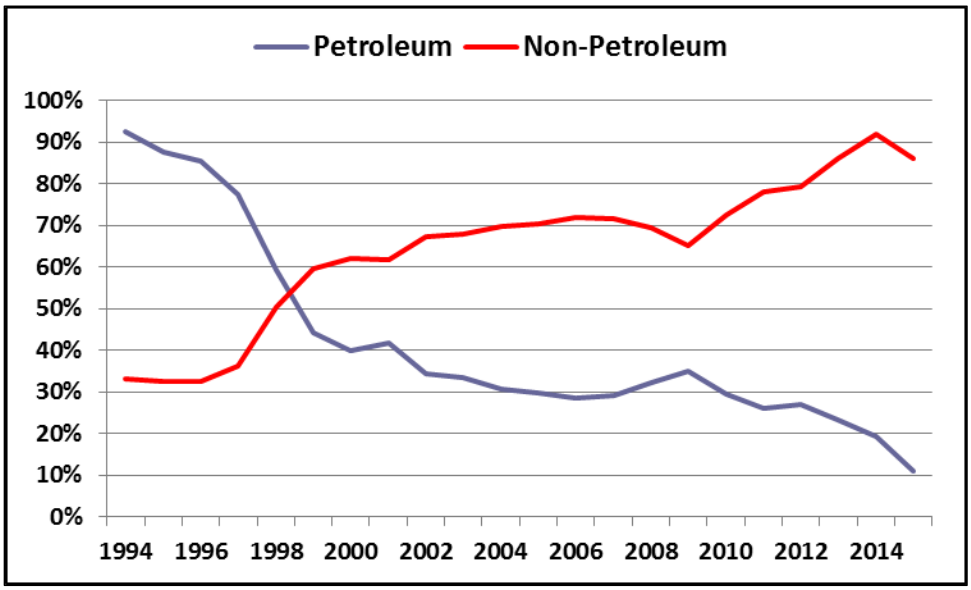
Despite the drop in the average annual price of imported crude oil and the decline in the role of imported crude oil in the value of the U.S. trade deficit in 2014 to 2016, the U.S. merchandise deficit increased in 2015 over that recorded in 2014. Instead of seeing the overall trade deficit decline, the composition of the trade deficit changed, with non-petroleum products replacing petroleum products, seemingly affirming the proposition that the overall value of the trade deficit is determined primarily by macroeconomic forces, as indicated in **Figure 3**.

[10] CRS Report R44546, The Economic Effects of Trade: Overview and Policy Challenges, by James K. Jackson.

[11] See CRS Report RS22204, *U.S. Trade Deficit and the Impact of Changing Oil Prices*, by James K. Jackson.

Figure 3. Share of Petroleum and Non-Petroleum Products in the U.S. Trade Deficit

(percent share of total U.S. merchandise trade deficit)



Source: Bureau of the Census.

According to the balance of payments accounts, the United States experienced deficits in the merchandise trade goods accounts over the last eight quarters in the range of $113 billion to $123 billion and a surplus in the services accounts during the same period in the range of about $61 to $67 billion, as indicated in **Table 2**. In the income accounts, which represent inflows of income on U.S. assets abroad relative to outflows of income earned on U.S. assets owned by foreigners, the net balance of the accounts was in surplus throughout the period.

Table 2. U.S. International Transactions, Selected Accounts

(billions of dollars)

			2015				2016		
	2014	2015	I	II	III	IV	I	II	III
Current account									
Balance on current account	$-392.1	$-463.0	$-114.5	$-111.9	$-123.1	$-113.4	$-131.8	$-118.3	$-113.0
Balance on goods and services	-490.2	-500.4	-126.5	-124.0	-125.6	-124.2	-125.2	-124.7	-116.4
Balance on goods	-752.2	-762.6	-193.5	-190.9	-189.8	-188.4	-186.3	-186.7	-177.7
Exports	1,633.3	1,510.3	383.9	383.9	377.2	365.3	354.1	360.2	375.9
Imports	-2,385.5	-2,272.9	-577.5	-574.8	-566.9	-553.7	540.4	547.0	553.6
Balance on services	262.0	262.2	67.0	66.8	64.2	64.2	61.1	62.0	61.3
Exports	743.3	750.9	188.3	188.4	187.1	187.0	184.7	186.2	188.2
Imports	-481.3	-488.7	-121.3	-121.6	-123.0	-122.8	123.7	124.2	126.9
Balance on primary income	224.0	182.4	48.4	45.1	41.8	47.1	34.0	44.2	43.4

			2015				2016		
	2014	2015	I	II	III	IV	I	II	III
Income Receipts	821.8	782.9	194.7	199.4	196.8	192.1	188.5	202.6	202.8
Income Payments	-597.8	-600.5	-146.4	-154.3	-154.9	-145.0	154.5	158.4	159.4
Unilateral current transfers	-125.9	-145.0	-36.4	-32.9	-39.3	-36.3	-40.6	-37.7	-39.9
Capital account									
Capital account transactions, net	0.0	0.0	-0.0	-0.0	-0.0	0.0	-0.1	0.0	0.0
Financial account									
Balance on financial account	-287.4	-195.2	-30.5	-99.6	-43.2	-21.8	-45.4	-41.0	-207.9
U.S.-owned assets abroad, net increase / outflow (+)	823.3	225.4	357.6	104.1	-83.8	-152.5	59.9	323.4	31.5
Private assets	926.1	502.6	319.6	255.5	-46.1	-26.3	10.1	252.7	52.4
Direct investment	343.4	348.6	86.6	114.8	51.3	96.0	67.4	106.3	87.5
Portfolio investment	582.7	154.0	233.1	140.7	-97.5	-122.3	-57.3	146.4	-35.1
Equities	431.6	202.6	197.2	113.7	-54.1	-54.2	-60.5	155.8	-25.4
Debt securities	151.1	-48.6	35.9	27.0	-43.4	-68.1	3.2	-9.4	-9.7
of which Treasury Sec.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government securities	41.0	-25.0	2.4	1.2	-15.4	-13.0	-12.2	4.3	10.1
Corporate securities	110.1	-23.6	33.5	25.8	-27.9	-55.1	15.4	-13.6	-19.8
Other investment assets	-99.2	-270.9	42.1	-150.5	-37.4	-125.1	51.0	70.6	-22.6
Private assets	-105.9	-275.6	40.4	-150.1	-38.3	-127.5	50.0	68.1	-27.2
Banks	-9.3	-7.6	-4.8	-30.0	-19.0	46.4	-20.3	26.8	-9.3
Non-bank financial	-96.6	-268.1	45.2	-120.1	-19.3	-173.9	70.3	41.3	-17.9
Official assets	6.7	4.7	1.7	-0.3	0.9	2.4	1.0	2.5	4.6
U.S. official reserve assets	-3.6	-6.3	-4.2	-0.9	-0.3	-1.0	-0.9	2.8	4.0
Foreign-owned assets in the U.S. net increase / inflow (+)	1,056.4	395.2	348.0	205.4	-39.9	-118.3	118.2	367.3	251.5
Private foreign-owned assets	798.2	728.5	297.0	364.2	-75.7	44.9	70.1	185.9	316.0
Direct investment	207.4	379.4	194.1	108.0	50.6	26.8	91.3	174.0	86.9
Portfolio investment	701.9	250.9	102.9	256.2	-126.3	18.1	-21.2	11.9	229.1
Private	590.8	349.0	102.9	256.2	-126.3	18.1	-21.2	11.9	229.1
Equities	165.3	-52.1	21.3	1.0	10.7	-85.1	-97.9	-28.0	127.3
Debt securities	433.7	521.4	91.6	156.2	71.3	202.4	216.7	142.8	193.7
Treasury securities	218.6	146.5	-17.3	-19.3	45.3	137.8	153.1	5.5	26.0
Other Federal agency	10.4	17.7	-7.5	29.0	8.3	-12.1	21.4	28.3	30.8
Corporate bonds	200.8	350.4	114.1	143.6	17.1	75.5	41.5	107.3	134.7

			2015				2016		
	2014	2015	I	II	III	IV	I	II	III
Official foreign-owned assets	111.0	-98.1	47.0	93.9	-164.2	-74.8	-99.0	-86.4	-105.6
Portfolio investment	102.9	-218.4	-9.9	98.9	-208.2	-99.2	-140.0	-102.9	-91.9
Equities	-11.0	-126.2	9.8	-23.6	-44.0	-68.4	2.2	-20.4	2.7
Debt securities	113.9	-92.2	-19.8	122.6	-164.2	-30.8	-142.2	-82.4	-94.5
Treasury securities	100.0	-98.1	-17.7	96.4	-157.7	-19.2	-134.1	-74.9	-106.5
Other Federal agency	-18.5	4.4	-5.7	26.9	-10.4	-6.3	-2.3	-3.4	1.5
Corporate bonds	32.0	1.5	3.6	-0.7	3.9	-5.3	-5.8	-4.2	10.3
Other investment liabilities	8.1	120.3	56.9	-5.0	44.0	24.4	41.0	16.5	-13.7
Other foreign-owned assets	147.1	-235.1	51.0	-158.7	35.8	-163.2	48.1	181.4	-64.5
Private	79.7	-413.5	-8.0	-170.5	-10.5	-224.6	21.9	150.8	-66.8
Banks	-78.5	-180.6	-17.6	-60.0	-30.2	-72.8	-40.3	84.2	-79.9
Non-bank financial inst.	158.1	-233.0	9.6	-110.6	19.7	-151.8	62.3	66.7	13.0
Official	67.5	178.4	59.0	11.8	46.3	61.4	26.1	30.5	2.3
Central bank	58.5	163.0	56.7	6.6	40.2	59.5	21.6	28.7	1.1
Financial derivatives	-54.3	-25.4	-40.2	1.7	0.7	12.4	13.0	2.9	12.1
Statistical discrepancy	104.7	267.8	83.9	12.3	79.9	91.6	86.5	77.3	-95.0

Source: Steiner, Christopher P. and Jeanine Aversa, U.S. International Transactions: Third Quarter 2016, BEA Release, December 15, 2016.

Note: An increase in U.S.-owned assets abroad is represented in the financial accounts by an outflow, which has been changed to a positive sign (+), and an increase in foreign-owned assets in the U.S. represents an inflow, also indicated by a positive sign (+).

The data also indicate that the U.S. financial accounts were in surplus throughout the period, because they represent the opposite and offsetting transactions to the deficits in the current account. Indeed, the accounting of the balance of payments is such that the surplus in the financial accounts is equivalent to the deficit in the combined balance in the capital account, the statistical discrepancy, and the balance on the current account. The balance in the financial accounts represents the difference between the capital outflows associated with U.S. investments abroad, which are recorded as a net positive outflow, and the capital inflows associated with foreign investment in the United States, which are recorded as a net positive inflow. These investment flows represent the combined amount of both private and official investments, or investments by private individuals and institutions and investments by governments and governmental institutions, respectively.

The balance on the financial account (the difference between the net U.S. acquisition of foreign financial assets and the net foreign acquisition of U.S. financial assets) in 2015 fell from that recorded in 2014 due to an increase in U.S. net purchases of assets abroad and a drop in foreign net purchases of assets in the United States. The relative decline in foreign acquisitions of U.S. assets in 2015 below those recorded in 2014 reflects a 180% drop in foreign official purchases of U.S. portfolio assets, including a decline of 200% in official purchases of U.S. Treasury

securities. Foreign private purchases of U.S. portfolio assets declined by 40%, reflecting a decline by 33% in foreign private purchases of U.S. treasury securities and an increase year-over-year of 75% in private purchases of corporate bonds.[12] During the same period, U.S. purchases of foreign equities and debt securities fell by 75%, year-over-year.

The data in **Table 2** also indicate that in 2015, the flows in direct investment, particularly foreign direct investment in the United States, experienced significant changes. U.S. direct investment abroad rose slightly in 2015 to reach $348.6 billion, and foreign direct investment in the United States rose by 83% to reach $379 billion. A lower value for foreign direct investment in 2014 reflected a $130 billion stock repurchase transaction that occurred between Verizon and the French-owned Vodafone.

Another way of viewing the balance of payments data is presented in **Table 3**, which shows the *net* amount of the flows in the major accounts, or the difference between the inflows and outflows. Net inflows are represented by positive numbers; net outflows are represented by negative numbers. In 2015 for instance, total net capital inflows representing the net balance on the current account, the capital account, and the statistical discrepancy, were a negative $195.2 billion, which was equivalent to the offsetting amount recorded in the financial accounts and is below the amount recorded in 2014. These values are subject to periodic revisions.

Table 3. Summary of the Net Balances by Major Accounts in the U.S. Balance of Payments

(billions of dollars)

			2015				2016		
	2014	2015	I	II	III	IV	I	II	III
Total Net Capital Inflows	$-287.4	$-195.2	$-30.6	$-99.6	$-43.2	$-21.8	$-45.4	-41.0	-207.9
Total Net Goods	-752.2	-762.6	-193.5	-190.9	-189.8	-188.4	-186.3	-186.7	-177.7
Total Net Services	262.0	262.2	67.0	66.8	64.2	64.2	61.1	62.0	61.3
Total Net Income	224.0	182.4	48.4	45.1	41.8	47.1	34.0	44.2	43.4
Total Net Transfers	-125.9	-145.0	-36.4	-32.9	-39.3	-36.3	-40.6	-37.7	-39.9
Total Net Capital Account	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0
Statistical Discrepancy	104.7	267.8	83.9	12.3	79.9	91.6	86.5	77.3	-95.0

[12] According to the Bureau of Economic Analysis (BEA), data on financial transactions that are reported in the balance of payments do not correspond directly to data in the U.S. Department of the Treasury's International Capital (TIC) report. BEA adjusts the TIC data on the differences in the outstanding amount, or holdings, of securities between the beginning and end of the reporting period, whether quarterly or annually, to account for changes in the value in the outstanding amount of securities that reflect (1) changes in prices; (2) changes in exchange rates; and (3) changes caused by other changes in the volume and value of securities. BEA also adjusts the TIC data to remove changes that are reflected in other data sources for direct investment and official reserve assets. BEA also reclassifies short-term securities and negotiable certificates of deposit of any maturity that are classified as other investment to portfolio investment. In addition, certain U.S. financial intermediaries that are not banks, securities brokers, bank holding companies, or financial holding companies report their holdings of debt with affiliates on BEA surveys of direct investment rather than to the TIC system; these data are added as financial intermediaries. BEA also uses partner country counterparty claims and liabilities provided by foreign banking authorities to close gaps in coverage of U.S. nonbanking concerns. Finally, BEA collects and adds holdings in other investment claims and liabilities of the U.S. central bank sector (Federal Reserve System) and the U.S. general government. "How BEA Aligns and Augments Source Data From the U.S. Treasury Department for Inclusion in the International Transactions Accounts," *Survey of Current Business*, September 2014.

			2015				2016		
	2014	2015	I	II	III	IV	I	II	III
Total Net Financial Account	287.4	195.2	30.6	99.6	43.2	21.8	45.4	41.0	207.9
Total Net Private Flows	-127.9	225.9	-22.7	108.7	-29.5	71.2	60.1	-66.7	263.6
Total Net Direct Investment	-136.1	30.8	107.5	-6.8	-0.7	-69.2	23.9	67.7	-0.6
Total Net Portfolio Invest.	119.2	97.0	-130.1	115.5	-28.8	140.4	36.1	-134.5	264.2
Total Net Private	8.1	195.1	-130.1	115.5	-28.8	140.4	36.1	-134.5	264.2
Total Net Equity Securities	-266.3	-254.7	-175.9	-112.7	64.8	-30.9	-37.4	-183.8	152.7
Total Net Debt Securities	282.6	570.0	55.7	129.2	114.6	270.5	213.5	152.2	203.4
Total Net Treasury Sec.	218.6	146.5	-17.3	-19.3	45.3	137.8	153.1	5.5	26.0
Other Government	-30.6	42.7	-9.8	27.8	23.8	0.9	33.5	24.1	20.7
Corporate	90.7	374.1	80.6	117.8	45.0	130.6	26.1	120.9	154.5
Other	4.0	6.8	2.2	2.9	0.5	1.2	0.8	1.7	2.2
Total Net Official	111.0	-98.1	47.0	93.9	-164.2	-74.8	-99.0	-86.4	-105.6
Total Net Portfolio	102.9	-218.4	-9.9	98.9	-208.2	-99.2	-140.0	-102.9	-91.9
Total Net Equity Securities	-11.0	-126.2	9.8	-23.6	-44.0	-68.4	2.2	-20.4	2.7
Total Net Debt Securities	113.9	-92.2	-19.8	122.6	-164.2	-30.8	-142.2	-82.4	-94.5
Total Net Treasury Sec.	100.0	-98.1	-17.7	96.4	-157.7	-19.2	-134.1	-74.9	-106.5
Other Government	-18.5	4.4	-5.7	26.9	-10.4	-6.3	-2.3	-3.4	1.5
Corporate	32.0	1.5	3.6	-0.7	3.9	-5.3	-5.8	-4.2	10.3
Other	0.4	0.1	0.0	0.1	0.0	-0.1	0.0	0.0	0.1
Total Net Other	0.0	0.0	-47.0	-93.9	164.2	74.8	99.0	86.4	105.6
Total Net Other	246.3	35.8	8.9	-8.3	73.2	-38.1	-2.9	110.8	-42.0
Private	185.6	-137.9	-48.3	-20.4	27.9	-97.0	-28.1	82.8	-39.6
Banks	-69.2	-173.0	-12.8	-29.9	-11.2	-119.1	-20.1	57.4	-70.5
Other Financial	254.8	35.1	-35.6	9.5	39.1	22.1	-8.0	25.4	30.9
Other Government	60.8	173.7	57.3	12.1	45.3	59.0	25.2	28.1	-2.3
Total Net Official Reserves	3.6	6.3	-4.2	-0.9	-0.3	-1.0	-1.2	0.2	1.6
Financial Derivatives	-54.3	-25.4	40.2	-1.7	-0.7	-12.4	13.0	47.2	235.4

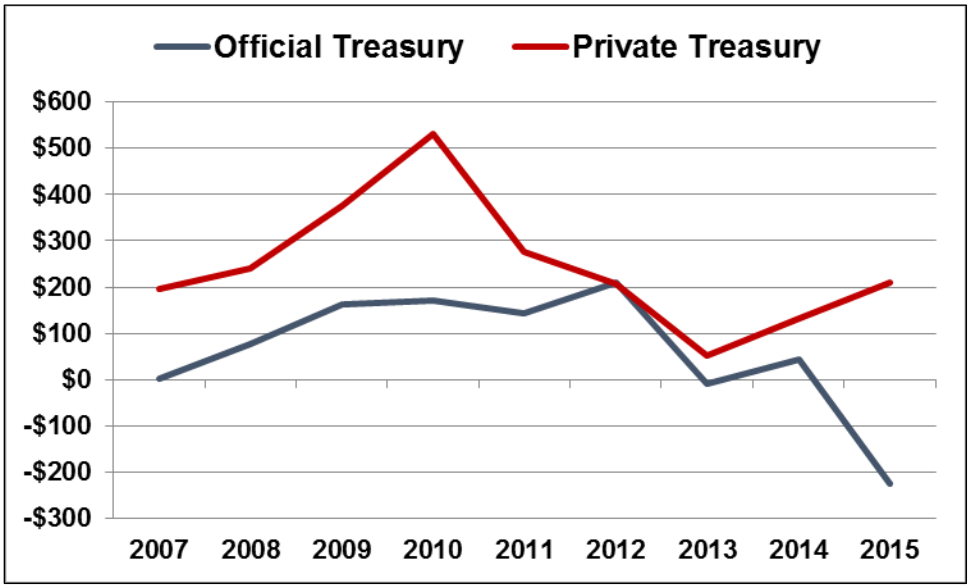
Source: Data developed by CRS from data published by the Department of Commerce.

Department of the Treasury data indicate that foreign private net purchases of Treasury securities have shifted between positive and negative values at various times, as indicated in **Figure 4**.[13] Foreign official net acquisitions of Treasury securities have also tended to change abruptly on an

[13] Department of the Treasury, Treasury International Capital System, available at: https://www.treasury.gov/resource-center/data-chart-center/tic/Pages/index.aspx.

annual basis, at times reflecting the role of the dollar and dollar-denominated securities as safe haven assets. During the midst of the financial crisis in 2009 and 2010, for instance, foreign private investors sharply increased their net purchases of Treasury securities, which rose to over $500 billion in 2010. From 2010 to 2013, however, as concerns over financial market stability eased foreign private net purchases of Treasury securities fell to $52 billion in 2013. Similarly, foreign governments increased their net purchases of Treasury securities in 2008 and 2009, which they maintained until foreign official net purchases fell in 2013 and again in 2015 when foreign official entities liquidated more than $200 billion in treasury securities.

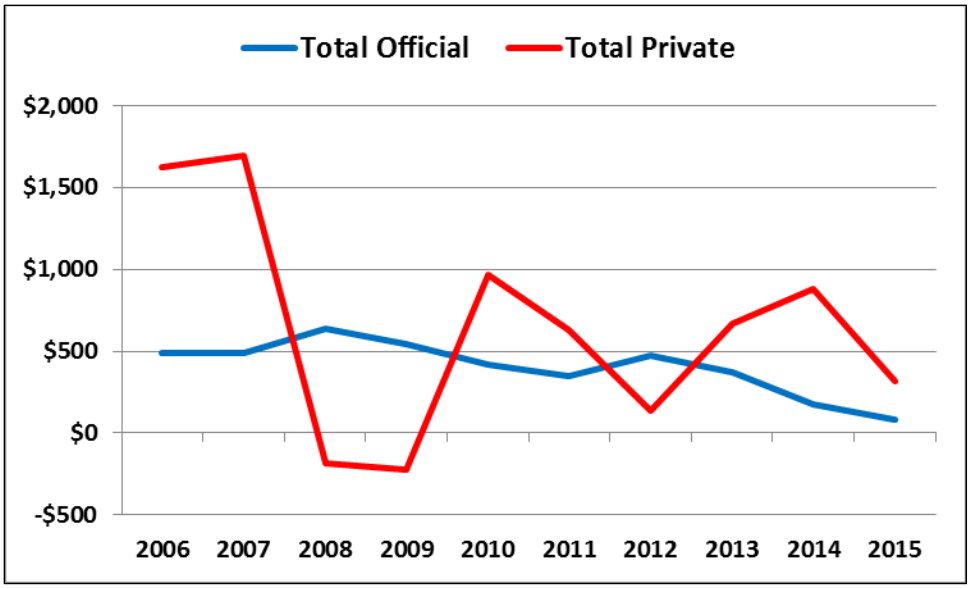
Figure 4. Foreign Private and Official Purchases of U.S. Treasury Securities, 2007-2015



Source: Department of the Treasury.

As **Figure 4** indicates, financial flows over the 2007-2015 net private and net official capital inflows have changed abruptly at times. Private capital flows, representing the combination of net purchases of Treasury securities, corporate stocks and bonds, and other U.S. Government agency bonds, shifted from a net inflow of $1.7 trillion in 2007 to a net outflow in 2008 and 2009, reflecting the contraction in capital flows as a result of the financial crisis. Between 2010 and 2015, net private inflows have varied sharply, often reflecting changes in private net purchases of a broad range of financial assets exclusive of Treasury securities. Net private inflows by U.S. citizens resumed in the 2012 to 2014 period. During the same period, net foreign official accumulations of U.S. financial assets increased from $188 billion in 2007 to $225 billion in 2012, shifting to a net outflow in 2015 of over $200 billion.

Figure 5. Net Inflows of Private and Official Sources of Capital, 2006-2015



Source: Department of the Treasury.

Table 4 data show the total net accumulation of long-term U.S. securities, or the amount of securities purchased less those that were sold, by foreign private and official sources from 2013 to 2015 and five recent quarters. The data indicate that in between 2013 and 2014, the net foreign private accumulation of U.S. securities tripled from $80 billion to $249 billion, before falling by a third to $155 billion in 2015. According to the Department of the Treasury, the drop in net foreign purchases of U.S. securities reflects adjustments by private investors in their portfolios by reducing their holdings of U.S. corporate stocks and U.S. Treasury securities and increasing their net purchases of corporate bonds and the bonds of U.S. government agencies other than Treasury securities.

Table 4. Net Foreign Purchases of Long-Term U.S. Securities

(billions of dollars)

	2013	2014	2015	2015-I	2015-II	2015-III	2015-IV	2016-I
Total private and official net purchases of U.S. securities	$79.4	$249.3	$155.6	$-0.6	$216.7	$-15.6	$-44.9	$60.2
Corporate stocks	-43.2	-16.1	-114.9	-9.5	-27.6	-38.2	-39.6	-23.0
Corporate bonds	10.3	25.3	134.1	26.5	41.8	44.2	21.7	43.0
U.S. Treasury bonds	40.9	165.5	-20.3	-53.1	131.8	-46.3	-52.7	-16.9
Federal agency bonds	71.5	74.6	156.7	35.5	70.8	24.7	25.8	57.2
Total private purchases	3.5	184.7	374.8	43.9	233.2	71.3	26.5	178.9
Corporate stocks	-38.9	-10.6	-98.5	-8.1	-24.9	-33.7	-31.9	-20.5
Europe	8.1	24.2	-24.8	-11.6	-9.9	1.5	-4.8	-4.7
United Kingdom	-0.3	-19.7	-15.5	0.2	-1.1	-16.1	1.5	-12.5

	2013	2014	2015	2015-I	2015-II	2015-III	2015-IV	2016-I
Canada	-3.2	10.2	-12.2	5.9	-7.6	0.7	-2.7	-2.6
Latin America	4.8	3.6	-1.1	-0.1	-0.6	-0.2	-0.2	-1.1
Asia	-29.6	-27.7	-33.3	-1.4	-14.8	-6.8	-10.4	-5.4
Of which: Japan	-26.4	-9.2	9.5	1.9	1.4	4.9	1.3	4.4
Corporate bonds	-6.8	17.6	137.7	25.8	41.3	46.5	24.1	44.0
Europe	-25.8	15.3	111.0	20.5	33.9	33.4	23.1	30.1
United Kingdom	19.1	77.2	127.4	23.4	36.6	34.5	32.9	34.3
Canada	-3.2	-5.6	-13.5	-1.3	-6.9	-1.7	-3.5	-3.4
Latin America	-2.5	0.6	4.5	1.4	1.9	0.6	0.6	1.1
Asia	23.3	-10.2	6.3	-3.5	5.1	5.5	-0.8	6.7
Of which: Japan	0.3	-11.5	-0.3	-3.4	1.9	3.3	-2.2	3.6
U.S. Treasury bonds	52.1	133.2	210.9	-2.0	164.9	34.6	13.3	109.4
Europe	58.2	-46.1	82.6	-57.6	88.2	4.1	47.9	72.2
Canada	-2.4	4.2	39.9	5.9	13.6	13.8	6.6	6.8
Latin America	-8.2	29.7	-23.2	0.1	3.2	-12.8	-13.7	-15.2
Asia	109.4	212.5	-153.8	-6.1	2.5	-78.9	-71.3	-69.2
Of which: Japan	62.6	10.7	-97.1	-7.7	-19.4	-27.3	-42.8	-2.1
Federal agency bonds	-2.8	44.4	124.7	28.2	51.8	23.9	20.9	46.0
Europe	45.4	31.8	45.7	10.4	24.7	2.4	8.3	15.9
United Kingdom	42.4	36.7	37.0	9.2	19.2	2.4	6.1	9.9
Canada	-2.9	3.6	9.1	4.1	2.8	1.5	0.6	1.0
Latin America	-9.6	-0.7	5.8	2.5	-1.4	7.7	-3.0	-0.9
Asia	51.6	51.6	93.4	19.0	42.7	13.7	17.9	38.0
Of which: Japan	-39.9	0.1	31.5	4.1	9.7	7.4	10.3	20.7
Total official purchases	78.8	78.3	-212.4	-40.1	-18.9	-84.3	-69.1	-114.8
U.S. Treasury bonds	-8.4	44.9	-225.9	-47.2	-35.6	-78.7	-64.3	-122.9
Other U.S. Government securities	75.2	31.4	33.5	8.0	19.0	1.0	5.4	11.4
Corporate bonds	16.2	7.0	-3.8	0.6	0.3	-2.3	-2.4	-0.7
Corporate stocks	-4.1	-4.9	-16.2	-1.5	-2.7	-4.4	-7.7	-2.6

Source: U.S. Department of the Treasury, Treasury International Capital System.

The U.S. Net International Investment Position

As indicated above, the data in **Table 2** and **Table 3** show that the trade deficit is accompanied by an equal capital inflow that represents an accumulation of dollar-denominated assets by foreigners. Some observers have equated the trade deficit and the associated accumulation of foreign-owned dollar-denominated assets as a debt that the U.S. economy owes to foreigners that will have to be repaid. This characterization, however, is not entirely appropriate. The debts owned by foreign investors represent claims on assets, rather than loans where payments on the principal and interest are specified according to a fixed schedule and where failure to meet the repayment schedule can result in the loans being called in and made payable in full. While foreign investors have expectations of a positive return on their dollar-denominated assets, returns, except for Treasury securities, are not guaranteed, but are subject to market forces. An important feature of claims by foreign investors on U.S. assets is that some or all of the profits or returns on the assets can be repatriated to the home country of the foreign investor, thereby reducing the returns that otherwise would remain in the U.S. economy. Depending on the tax convention the United States has with other governments, private foreign investors who own U.S. Treasury securities will owe taxes on the interest income.

According to the most commonly accepted approach to the balance of payments, macroeconomic developments in the U.S. economy are the major driving forces behind the magnitudes of capital flows, because the macroeconomic factors determine the overall demand for and supply of capital in the economy. Economists generally conclude that the rise in capital inflows can be attributed to comparatively favorable returns on investments in the United States when adjusted for risk, a surplus of saving in other areas of the world, the well-developed U.S. financial system, the overall stability of the U.S. economy, and the generally held view that U.S. securities, especially Treasury securities, are high quality financial instruments that are low risk. In turn, these net capital inflows (inflows net of outflows) bridge the gap in the United States between the amount of credit demanded and the domestic supply of funds, likely keeping U.S. interest rates below the level they would have reached without the foreign capital. These capital inflows also allow the United States to spend beyond its means, including financing its trade deficit, because foreigners are willing to lend to the United States in the form of exchanging goods, represented by U.S. imports, for such U.S. assets as stocks, bonds, U.S. Treasury securities, and real estate and U.S. businesses.

While this exchange of assets is implicit in the balance of payments, the Department of Commerce explicitly accounts for this broad flow of dollar-denominated assets through the nation's net international investment position. The U.S. net international investment position represents the accumulated value of U.S.-owned assets abroad and foreign-owned assets in the United States measured on an annual basis at the end of the calendar year. Some observers refer to the net of this investment position (or the difference between the value of U.S.-owned assets abroad and the value of foreign-owned assets in the United States) as a debt, or indicate that the United States is a net debtor nation, because the value of foreign-owned assets in the United States is greater than the value of U.S.-owned assets abroad.

In fact, the nation's net international investment position is not a measure of the nation's indebtedness similar to the debt borrowed by some developing countries, but it is simply an accounting of assets. The Department of Commerce uses three different methods for valuing direct investments that can yield different estimates for the net position, depending on the stock

market value of the investments.[14] For example, by year-end 2015 the overseas assets of U.S. residents totaled $22.0 trillion, with U.S. direct investment abroad valued at historical cost, while foreigners had acquired about $28.0 trillion in assets in the United States, with direct investment measured at historical cost. As a result, the U.S. net international investment position was about a negative $5.6 trillion in 2015, with direct investment measured at historical cost, but was valued at negative $7.3 with direct investment valued at current cost, as indicated in **Table 5**.

Table 5. U.S. Net International Investment Position

(billions of dollars)

Type of Investment	2012	2013	2014	2015
Net international investment position of the United States:				
With direct investment at current cost	$-4,518.3	$-5,372.7	$-7,046.1	$-7,280.6
With direct investment at market value	-4,000.1	-4,826.5	-5,913.1	-5,808.7
With direct investment at historical cost	-3,794.8	-4,611.6	-5,717.6	-5,643.0
Net Financial derivatives	57.8	77.6	85.5	57.2
U.S. Assets				
With direct investment at current cost	22,562.2	24,144.8	24,717.5	23,340.8
With direct investment at market value	21,002.7	21,603.8	22,413.8	21,403.1
With direct investment at historical cost	21,610.5	22,238.7	23,042.3	22,011.0
U.S. Assets excluding financial derivatives	18,942.4	21,127.7	21,503.4	20,945.4
Financial derivatives	3,619.8	3,017.1	3,214.1	2,395.4
U.S. Direct Investment Abroad				
—At current cost	5,969.5	7,120.7	7,133.1	6,978.3
—At market value	4,410.0	4,579.7	4,829.4	5,040.6
—At historical cost	5,017.8	5,214.6	5,457.9	5,648.6
Portfolio Investment	7,984.0	9,206.1	9,704.3	9,606.2
—Equities	5,321.9	6,472.9	6,770.6	6,828.2
—Debt securities	2,662.1	2,733.2	2,933.6	2,777.9
Other Investment	4,416.6	4,352.5	4,231.8	3,977.3
Currency and Deposits	2,061.7	1,975.7	1,785.5	1,628.6
Loans	2,299.2	2,323.5	2,399.2	2,304.0
Other	55.7	53.4	47.0	44.7
Reserve Assets	572.4	448.3	434.3	383.6
U.S. Liabilities				
With direct investment at current cost	27,080.5	29,517.4	31,763.7	30,621.4
With direct investment at market value	25,002.7	26,430.3	28,326.9	27,211.8
With direct investment at historical cost	25,405.3	26,850.3	28,759.9	27,654.0
U.S. Liabilities excluding financial derivatives	23,518.5	26,577.9	28,635.1	28,283.3

[14] For additional information, see CRS Report RL32964, *The United States as a Net Debtor Nation: Overview of the International Investment Position*, by James K. Jackson.

Type of Investment	2012	2013	2014	2015
Financial derivatives	3,562.0	2,939.5	3,128.6	2,338.1
Foreign Direct Investment in the United States				
—At current cost	4,662.4	5,814.9	6,350.1	6,543.8
—At market value	2,584.7	2,727.8	2,913.3	3,134.2
—At historical cost	2,987.3	3,147.8	3,346.3	3,576.4
Portfolio Investment	13,978.9	15,541.3	16,919.8	16,677.0
Private portfolio investment	8,615.7	9,973.9	11,175.3	11,128.7
Equity	3,843.0	4,968.9	5,664.9	5,400.2
Debt securities, of which:	4,772.8	5,005.1	5,510.5	5,728.5
Treasury securities	288.9	287.1	336.3	388.0
Treasury bonds	1,249.7	1,450.9	1,697.1	1,665.5
Corporate bonds	3,063.7	3,087.0	3,276.0	3,481.0
Official portfolio investment	5,363.1	5,567.3	5,744.5	5,548.3
Equity	702.4	895.7	977.6	818.6
Debt securities, of which:	4,660.8	4,671.6	4,766.8	4,729.6
Treasury securities	372.7	398.4	335.3	336.7
Treasury bonds	3,660.1	3,656.2	3,787.3	3,757.9
Corporate bonds	615.2	590.9	605.1	598.5
Other Investment	4,877.2	5,221.7	5,365.2	5,062.5
Other official investment	318.8	380.0	390.0	508.0
Other private investment	4,558.4	4,841.7	4,975.3	4,554.4
Currency and deposits	2,442.1	2,460.6	2,675.7	2,584.1
Loans	2,048.2	2,315.1	2,228.8	1,901.1
Total U.S. Liabilities to foreign official agencies	5,681.9	5,947.4	6,134.4	6,056.3
Total U.S. Liabilities to private entities	13,278.2	15,788.9	17,525.4	17,672.5

Source: Gohrband, Christopher, et al., The International Investment Position of the United States at the End of the First Quarter of 2016, Year 2015, and Annual Revisions, *BEA New Release*, June 30, 2016.

Foreign investors who acquire U.S. assets do so at their own risk and accept the returns accordingly. While foreign investors likely expect positive returns from their dollar-denominated assets, the returns on most of the assets in the international investment position, except for bonds, are not guaranteed and foreign investors stand to gain or lose on them similar to the way U.S. domestic investors gain or lose.

As **Table 5** indicates, investments in the international investment position include such financial assets as corporate stocks and bonds, government securities, and direct investment[15] in businesses

[15] The United States defines foreign direct investment as the ownership or control, directly or indirectly, by one foreign person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest in an unincorporated U.S. business enterprise. 15 C.F.R. §806.15 (a)(1). Similarly, the United States defines direct investment abroad as the ownership or control, directly or

and real estate. The value of these assets, measured on an annual basis, can change as a result of purchases and sales of new or existing assets; changes in the financial value of the assets that arise through appreciation, depreciation, or inflation; changes in the market values of stocks and bonds; or changes in the value of currencies. For instance, by year-end 2015, U.S. holdings abroad had risen in value to $22 trillion, with direct investment valued at historical cost, and $23.2 trillion and $21.4 trillion with direct investment valued at current cost and market value, respectively, reflecting an upward revaluation in the values of foreign corporate stocks due to an increase in stock market values. Similarly, the value of foreign owned assets in the United States rose in 2015 to $27.2 trillion with direct investment valued at historical cost and $30.6 trillion with direct investment valued at market cost, with rising stock values pulling up the overall investment position of foreign investors.

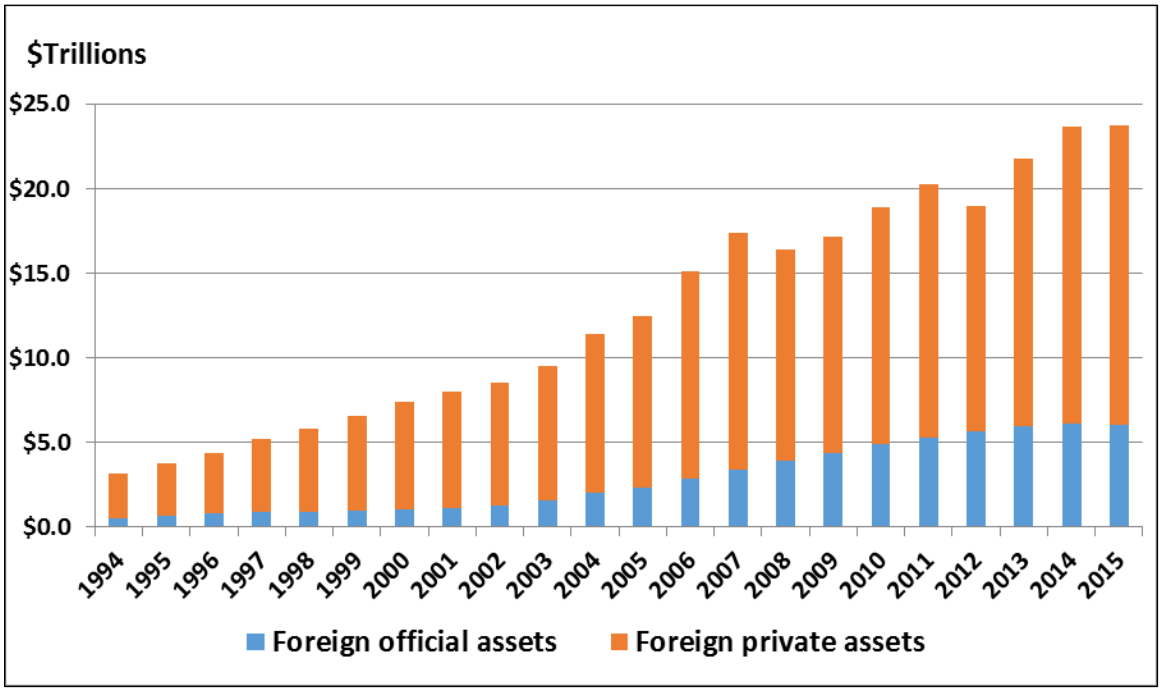
The foreign investment position in the United States continues to increase as foreigners acquire additional U.S. assets and as the value of existing assets appreciates. These assets are broadly divided into official and private investments, reflecting transactions by governments among themselves and transactions among the public. While the foreign official share of the overall amount of capital inflows has grown sharply as indicated in **Table 3**, the overall foreign official share of foreign-owned assets in the United States has remained relatively modest.

As **Figure 6** indicates, foreign official asset holdings were valued at about $6.0 trillion in 2015, or about 20% of the total foreign investment position, a share that rose above 20% in 2008 as foreign official holdings of U.S. Treasury securities rose during the global financial crisis. Official assets include such monetary reserve assets as gold, the reserve position with the International Monetary Fund (IMF), and holdings of foreign currency. An important component of foreign official holdings in the United States is the acquisitions of U.S. Treasury securities by foreign governments. At times, such acquisitions are used by foreign governments, either through coordinated actions or by themselves, to affect the foreign exchange price of the dollar. Foreign currency holdings account for a relatively small share of the total foreign investment position.[16]

indirectly, by one person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise. 15 C.F.R. §806.15 (a)(1).

[16] For additional information, see CRS Report RL32462, *Foreign Investment in U.S. Securities*, by James K. Jackson.

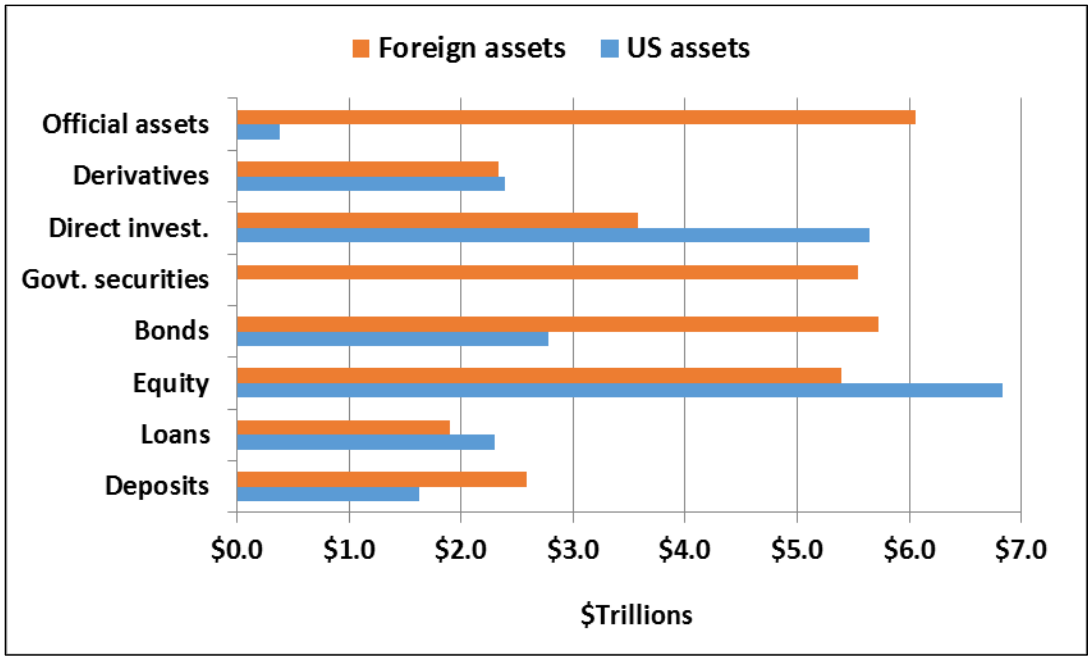
Figure 6. Foreign Official and Private Investment Positions in the United States, 1994-2015



Source: Department of Commerce.

Private asset holdings are comprised primarily of direct investment in businesses and real estate, purchases of publicly traded government securities, and corporate stocks and bonds. As indicated in **Figure 7**, the composition of U.S. assets abroad and foreign-owned assets in the United States differs in a number of ways. The strength and uniqueness of the U.S. Treasury securities markets make these assets sought after by both official and private foreign investors, whereas U.S. investors hold few foreign government securities. As a result, foreign official assets in the United States far outweigh U.S. official assets abroad. Both foreign private and official investors have been drawn at times to U.S. government securities as a safe haven investment during troubled or unsettled economic conditions.

Figure 7. U.S. and Foreign Investment Position, By Major Component, 2015



Source: Department of Commerce.

Implications

The persistent U.S. trade deficit raises concerns in Congress and elsewhere due to the potential risks such deficits may pose for the long-term rate of growth for the economy. In particular, some observers are concerned that foreigner investors' portfolios will become saturated with dollar-denominated assets and foreign investors will become unwilling to accommodate the trade deficit by holding more dollar-denominated assets. The shift in 2004 in the balance of payments toward a larger share of assets being acquired by official sources generated speculation that foreign private investors had indeed reached the point where they were no longer willing to add more dollar-denominated assets to their portfolios. This shift was reversed in 2005, however, as foreign private investments rebounded.

Another concern is with the outflow of profits that arise from the dollar-denominated assets owned by foreign investors. This outflow stems from the profits or interest generated by the assets and represents a clear outflow of capital from the economy that otherwise would not occur if the assets were owned by U.S. investors. These capital outflows represent the most tangible cost to the economy of the present mix of economic policies in which foreign capital inflows are needed to fill the gap between the demand for capital in the economy and the domestic supply of capital.

Indeed, as the data presented indicate, it is important to consider the underlying cause of the trade deficit. According to the most commonly accepted economic approach, in a world with floating exchange rates and the free flow of large amounts of dollars in the world economy and international access to dollar-denominated assets, macroeconomic developments, particularly the demand for and supply of credit in the economy, are the driving forces behind the movements in the dollar's international exchange rate and, therefore, the price of exports and imports in the economy. As a result, according to this approach, the trade deficit is a reflection of macroeconomic conditions within the domestic economy, and an attempt to address the issue of

the trade deficit without addressing the underlying macroeconomic factors in the economy likely would prove to be of limited effectiveness.

In addition, the nation's net international investment position indicates that the largest share of U.S. assets owned by foreigners is held by private investors who acquired the assets for any number of reasons. As a result, the United States is not in debt to foreign investors or to foreign governments similar to some developing countries that run into balance of payments problems, because the United States has not borrowed to finance its trade deficit. Instead the United States has traded assets with foreign investors who are prepared to gain or lose on their investments in the same way private U.S. investors can gain or lose. It is certainly possible that foreign investors, whether they are private or official, could eventually decide to limit their continued acquisition of dollar-denominated assets or even reduce the size of their holdings, but there is no firm evidence that such presently is the case.

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