Chapter 13 Update: Accounting Frameworks

Kenneth A. Reinert, *An Introduction to International Economics: New Perspectives on the World Economy*, Cambridge University Press, 2012.

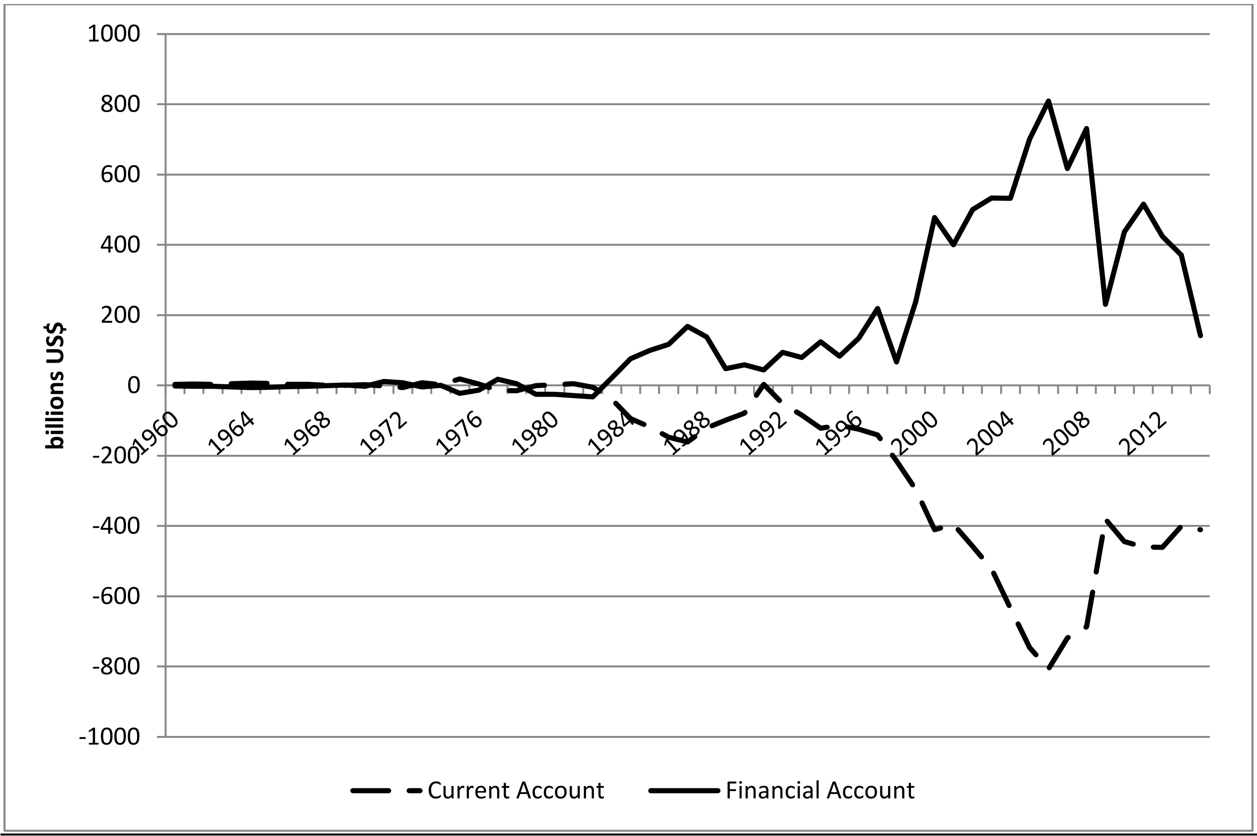
Let's examine whether this proposition holds in the current world economy. We do this from the developed country perspective first, considering the United States. Figure 13.3 plots the current account and capital/financial account transactions of the U.S. balance of payments from 1960 to 2014.[1] Between 1960 and 1983, the United States was not a significant borrower (positive entries) or a significant lender (negative entries) on the capital/financial account. Beginning in 1984, however, and in contraindication to the developed country as lender story just described, the United States began to *borrow* from abroad on the capital/financial account as part of the Reagan Administration's expansive fiscal policies and consequent decline of U.S. government savings. The concurrent expansion of government deficits and current account deficits became known as the "twin deficits." This borrowing began to decline in 1989.

A second episode of foreign borrowing on the capital/financial account began in 1993. Unlike the decade of the 1980's, this was due to a collapse of household savings rather than government savings. Beginning in 2001, an entirely new episode of foreign borrowing on the capital/financial account began on a much larger scale, reaching a peak of $800 billion in 2006.[2] This was the result of a deficit of domestic savings as a whole (both household and government), wars in Afghanistan and Iraq, and government tax cuts. Rather than being a source of capital for the developing world, the Unites States became a capital sink. Since 2006, this foreign borrowing to cover a current account deficit has been on a steady decline.

[1] Note that Figure 13.3 plots reserve account *transactions* or flows, not the holdings or stocks of foreign reserves.

[2] *The Economist* (2005) reported that "the growing imbalances are weakening America's economy, not only because of the extra foreign debt the country has taken on, but because of the domestic toll of being the world's consumer of last resort. America is saving too little and not investing enough in productive assets, especially in the export sector" (p. 24).

Figure 13.3 United States Capital/Financial and Official Reserves Account Transactions, 1960 to 2014 (billions of US $)



Source: Unites States Bureau of Economic Analysis