

UNIT 6

Open Economy - International Trade and Finance



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OPEN ECONOMY - INTERNATIONAL TRADE AND FINANCE

M1: Open-Economy Macroeconomics: Basic Concepts

I. We will no longer be assuming that the economy is a closed economy.

- A. Definition of closed economy: an economy that does not interact with other economies in the world.
- B. Definition of open economy: an economy that interacts freely with other economies around the world.

II. The International Flows of Goods and Capital

A. The Flow of Goods: Exports, Imports, and Net Exports

- 1. Definition of exports: goods and services that are produced domestically and sold abroad.
- 2. Definition of imports: goods and services that are produced abroad and sold domestically.
- 3. Definition of net exports: the value of a nation's exports minus the value of its imports, also called the **trade balance**.

$$\text{Net export} = \text{Value of country's exports} - \text{Value of country's imports}$$

- 4. Definition of trade balance: the value of a nation's exports minus the value of its imports, also called net exports.
- 5. Definition of trade surplus: an excess of exports over imports.
- 6. Definition of trade deficit: an excess of imports over exports.
- 7. Definition of balanced trade: a situation in which exports equal imports.
- 8. There are several factors that influence a country's exports, imports, and net exports:
 - a. The tastes of consumers for domestic and foreign goods.
 - b. The prices of goods at home and abroad.
 - c. The exchange rates at which people can use domestic currency to buy foreign currencies.

- d. The incomes of consumers at home and abroad.
- e. The cost of transporting goods from country to country.
- f. Government policies toward international trade.

B. The Flow of Financial Resources: Net Capital Outflow

1. Definition of **net capital outflow (NCO)**: the purchase of foreign assets by domestic residents minus the purchase of domestic assets by foreigners.

Net capital outflow = Purchase of foreign assets by domestic residents – Purchase of domestic assets by foreigners

2. The flow of capital abroad takes two forms.

- a. Foreign direct investment occurs when a capital investment is owned and operated by a foreign entity.
- b. Foreign portfolio investment involves an investment that is financed with foreign money but operated by domestic residents.

3. Net capital outflow can be positive or negative.

- a. When net capital outflow is positive, domestic residents are buying more foreign assets than foreigners are buying domestic assets. Capital is flowing out of the country.
- b. When net capital outflow is negative, domestic residents are buying fewer foreign assets than foreigners are buying domestic assets. The country is experiencing a capital inflow.

4. There are several factors that influence a country's net capital outflow:

- a. The real interest rates being paid on foreign assets.
- b. The real interest rates being paid on domestic assets.
- c. The perceived economic and political risks of holding assets abroad.
- d. The government policies that affect foreign ownership of domestic assets.

C. The Equality of Net Exports and Net Capital Outflow

1. Net exports and net capital outflow each measure a type of imbalance in a world market.

- a. Net exports measure the imbalance between a country's exports and imports in world markets for goods and services.
- b. Net capital outflow measures the imbalance between the amount of foreign assets bought by domestic residents and the amount of domestic assets bought by foreigners in world financial markets.

2. For an economy, **net exports must be equal to net capital outflow**.

3. Example: You are a computer programmer who sells some software to a Japanese consumer for 10,000 yen.

- a. The sale is an export of the United States so U.S. net exports increase.
- b. There are several things you could do with the 10,000 yen

- c. You could hold the yen (which is a Japanese asset) or use it to purchase another Japanese asset. Either way, U.S. net capital outflow rises.
- d. Alternatively, you could use the yen to purchase a Japanese good. Thus, U.S. imports will rise so the net effect on net exports will be zero.
- e. One final possibility is that you could exchange the yen for dollars at a bank. This does not change the situation though, because the bank then must use the yen for something.

4. This example can be generalized to the economy as a whole.

- a. When a nation is running a trade surplus ($NX > 0$), it must be using the foreign currency to purchase foreign assets. Thus, capital is flowing out of the country ($NCO > 0$).
- b. When a nation is running a trade deficit ($NX < 0$), it must be financing the net purchase of these goods by selling assets abroad. Thus, capital is flowing into the country ($NCO < 0$).

5. Every international transaction involves exchange. When a seller country transfers a good or service to a buyer country, the buyer country gives up some asset to pay for the good or service.

6. Thus, the net value of the goods and services sold by a country (net exports) must equal the net value of the assets acquired (net capital outflow).

D. Saving, Investment, and Their Relationship to the International Flows

1. Recall that GDP (Y) is the sum of four components: consumption (C), investment (I), government purchases (G) and net exports (NX).

$$Y = C + I + G + NX$$

2. Recall that national saving is equal to the income of the nation after paying for current consumption and government purchases.

$$S = Y - C - G$$

3. We can rearrange the equation for GDP to get:

$$Y - C - G = I + NX$$

Substituting for the left-hand side, we get:

$$S = I + NX$$

4. Because net exports and net capital outflow are equal, we can rewrite this as:

$$S = I + NCO$$

5. This implies that saving is equal to the sum of domestic investment (I) and net capital outflow (NCO).

6. When a U.S. citizen saves \$1 of her income, that dollar can be used to finance the accumulation of domestic capital or it can be used to finance the purchase of foreign capital.

7. Note that, in a closed economy such as the one we assumed earlier, net capital outflow would equal zero and saving would simply be equal to domestic investment.

III. The Prices for International Transactions: Real and Nominal Exchange Rates

A. Nominal Exchange Rates

1. Definition of **nominal exchange rate**: the rate at which a person can trade the currency of one country for the currency of another.
2. An exchange rate can be expressed in two ways.
 - a. Example: 80 yen per dollar.
 - b. This can also be written as 1/80 dollar (or 0.0125 dollar) per yen.
3. Definition of **appreciation**: an increase in the value of a currency as measured by the amount of foreign currency it can buy.
4. Definition of **depreciation**: a decrease in the value of a currency as measured by the amount of foreign currency it can buy.
5. When a currency appreciates, it is said to strengthen; when a currency depreciates, it is said to weaken.
6. When economists study nominal exchange rates, they often use an exchange rate index, which converts the many nominal exchange rates into a single measure.

B. Real Exchange Rates

1. Definition of **real exchange rate**: the rate at which a person can trade the goods and services of one country for the goods and services of another.
2. Example: A bushel of American rice sells for \$100 and a bushel of Japanese rice sells for 16,000 yen. The nominal exchange rate is 80 yen per dollar.
3. The real exchange rate depends on the nominal exchange rate and on the prices of goods in the two countries measured in the local currencies.

$$\text{Real exchange rate} = \frac{\text{Nominal exchange rate} \times \text{Domestic Price}}{\text{Foreign Price}}$$

In our example:

$$\text{real exchange rate} = \frac{(80 \text{ yen per dollar}) (\$100 \text{ per bushel of American rice})}{16,000 \text{ yen per bushel of Japanese rice}}$$

$$\text{real exchange rate} = \frac{8,000 \text{ yen per bushel of American rice}}{16,000 \text{ yen per bushel of Japanese rice}}$$

$$\text{real exchange rate} = 1/2 \text{ bushel of Japanese rice per bushel of American rice}$$

5. The real exchange rate is a key determinant of how much a country exports and imports.
6. When studying an economy as a whole, macroeconomists focus on overall prices instead of the prices of individual goods and services.

- a. Price indexes are used to measure the level of overall prices.
- b. Assume that P is the price index for the United States, P^* is a price index for prices abroad, and e is the nominal exchange rate between the U.S. dollar and foreign currencies.

$$\text{real exchange rate} = \frac{e \times P}{P^*}$$

7. The real exchange rate measures the price of a basket of goods and services available domestically relative to the price of a basket of goods and services available abroad.
8. A depreciation in the U.S. real exchange rate means that U.S. goods have become cheaper relative to foreign goods. U.S. exports will rise, imports will fall, and net exports will increase.
9. Likewise, an appreciation in the U.S. real exchange rate means that U.S. goods have become more expensive relative to foreign goods. U.S. exports will fall, imports will rise, and net exports will decline.

IV. A First Theory of Exchange-Rate Determination: Purchasing-Power Parity

A. Definition of **purchasing-power parity**: a theory of exchange rates whereby a unit of any given currency should be able to buy the same quantity of goods in all countries.

B. The Basic Logic of Purchasing-Power Parity

1. The law of one price suggests that a good must sell for the same price in all locations.
 - a. If a good sold for less in one location than another, a person could make a profit by buying the good in the location where it is cheaper and selling it in the location where it is more expensive.
 - b. The process of taking advantage of differences in prices for the same item in different markets is called arbitrage.
 - c. Note what will happen as people take advantage of the differences in prices. The price in the location where the good is cheaper will rise (because the demand is now higher) and the price in the location where the good was more expensive will fall (because the supply is greater). This will continue until the two prices are equal.
2. The same logic should apply to currency.
 - a. A U.S. dollar should buy the same quantity of goods and services in the United States and Japan; a Japanese yen should buy the same quantity of goods and services in the United States and Japan.
 - b. Purchasing-power parity suggests that a unit of all currencies must have the same purchasing power in every country.
 - c. If this was not the case, people would take advantage of the profit-making opportunity and this arbitrage would then push the real values of the currencies to equality.

C. Implications of Purchasing-Power Parity

1. Purchasing-power parity means that the nominal exchange rate between the currencies of two countries will depend on the price levels in those countries.

2. If a dollar buys the same amount of goods and services in the United States (where prices are measured in dollars) as it does in Japan (where prices are measured in yen), then the nominal exchange rate (the number of yen per dollar) must reflect the prices of goods and services in the two countries.
3. Suppose that P is the price of a basket of goods in the United States (measured in dollars), P^* is the price of a basket of goods in Japan (measured in yen), and e is the nominal exchange rate (the number of yen each dollar can buy).
 - a. In the United States, the purchasing power of \$1 is $1/P$.
 - b. In Japan, \$1 can be exchanged for e units of yen, which in turn have the purchasing power of e/P^* .
 - c. Purchasing-power parity implies that the two must be equal:

$$1/P = e/P^*$$

- d. Rearranging, we get:

$$1 = (eP)/P^*$$

Note that the left-hand side is a constant and the right-hand side is the real exchange rate. This implies that if the purchasing power of a dollar is always the same at home and abroad, then the real exchange rate cannot change.

- e. We can rearrange again to see that:

$$e = P^*/P$$

The nominal exchange rate is determined by the ratio of the foreign price level to the domestic price level. Nominal exchange rates will change when price levels change.

4. Because the nominal exchange rate depends on the price levels, it must also depend on the money supply and money demand in each country.
 - a. If the central bank increases the supply of money in a country and raises the price level, it also causes the country's currency to depreciate relative to other currencies in the world.
 - b. When a central bank prints large quantities of money, that money loses value both in terms of the goods and services it can buy and in terms of the amount of other currencies it can buy.

D. Limitations of Purchasing-Power Parity

1. Exchange rates do not always move to ensure that a dollar has the same real value in all countries all of the time.
2. There are two reasons why the theory of purchasing-power parity does not always hold in practice.
 - a. Many goods are not easily traded (haircuts in Paris versus haircuts in New York). Thus, arbitrage would be too limited to eliminate the difference in prices between the locations.
 - b. Tradable goods are not always perfect substitutes when they are produced in different countries (American cars versus German cars). There is no opportunity for arbitrage here, because the price difference reflects the different values the consumer places on the two products.

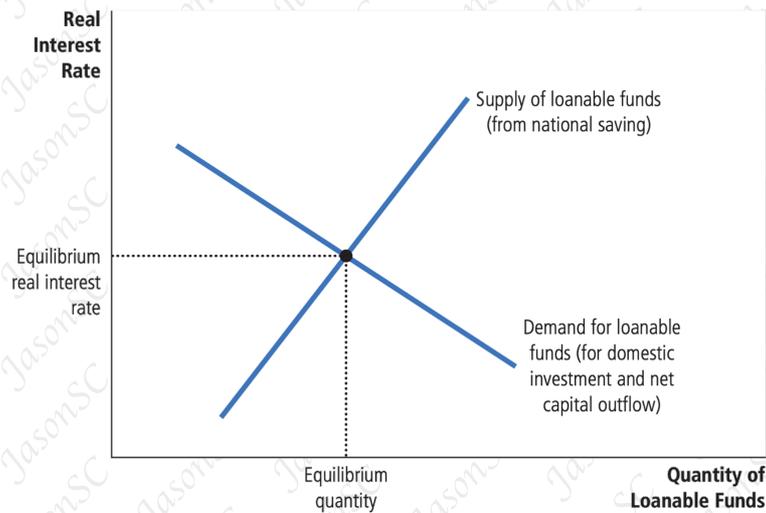
M2: A Macroeconomic Theory of the Open Economy

I. Supply and Demand for Loanable Funds and for Foreign-Currency Exchange

A. The Market for Loanable Funds

1. Whenever a nation saves a dollar of income, it can use that dollar to finance the purchase of domestic capital or to finance the purchase of an asset abroad.
2. The supply of loanable funds comes from national saving.
3. The demand for loanable funds comes from domestic investment and net capital outflow.
 - a. Because net capital outflow can be positive or negative, it can either add to or subtract from the demand for loanable funds that arises from domestic investment.
 - b. When $NCO > 0$, the country is experiencing a net outflow of capital. When $NCO < 0$, the country is experiencing a net inflow of capital.
4. The quantity of loanable funds demanded and the quantity of loanable funds supplied depend on the real interest rate.
 - a. A higher real interest rate encourages people to save and thus raises the quantity of loanable funds supplied.
 - b. A higher interest rate makes borrowing to finance capital projects more costly, discouraging investment and reducing the quantity of loanable funds demanded.
 - c. A higher real interest rate in a country will also lower net capital outflow. All else being equal, a higher domestic interest rate implies that purchases of foreign assets by domestic residents will fall and purchases of domestic assets by foreigners will rise.
5. The supply and demand for loanable funds can be shown graphically.
 - a. The real interest rate is the price of borrowing funds and is therefore on the vertical axis; the quantity of loanable funds is on the horizontal axis.
 - b. The supply of loanable funds is upward sloping because of the positive relationship between the real interest rate and the quantity of loanable funds supplied.
 - c. The demand for loanable funds is downward sloping because of the inverse relationship between the real interest rate and the quantity of loanable funds demanded.
6. The interest rate adjusts to bring the supply and demand for loanable funds into balance.
 - a. If the interest rate were below r^e , the quantity of loanable funds demanded would be greater than the quantity of loanable funds supplied. The shortage of loanable funds would lead to upward pressure on the interest rate.
 - b. If the interest rate were above r^e , the quantity of loanable funds demanded would be less than the quantity of loanable funds supplied. The surplus of loanable funds would lead to downward pressure on the interest rate.
7. At the equilibrium interest rate, the amount that people want to save is exactly equal to the desired quantities of domestic investment and net capital outflow.

Figure 1 The Market for Loanable Funds

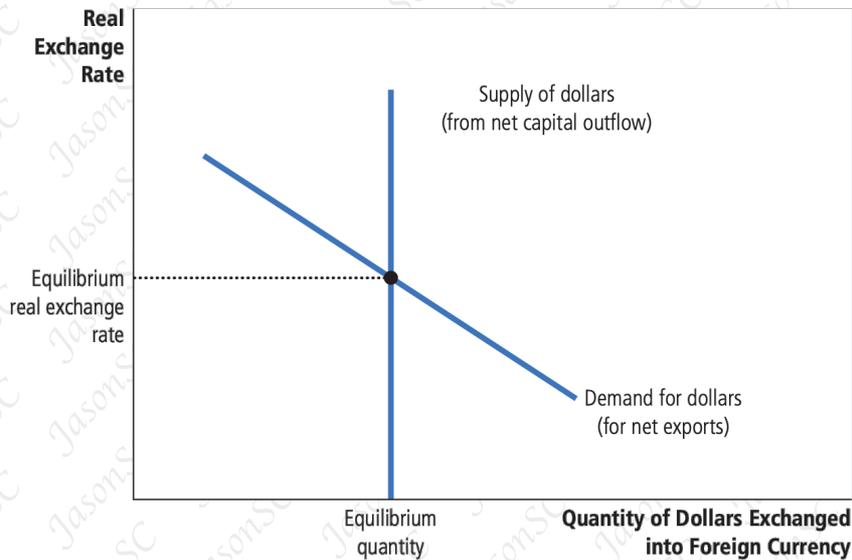


B. The Market for Foreign-Currency Exchange

1. The imbalance between the purchase and sale of capital assets abroad must be equal to the imbalance between exports and imports of goods and services.
2. Net capital outflow represents the quantity of dollars supplied for the purpose of buying assets abroad.
3. Net exports represent the quantity of dollars demanded for the purpose of buying U.S. net exports of goods and services.
4. The real exchange rate is the price that balances the supply and demand in the market for foreign-currency exchange.
 - a. When the U.S. real exchange rate appreciates, U.S. goods become more expensive relative to foreign goods, lowering U.S. exports and raising imports. Thus, an increase in the real exchange rate will reduce the quantity of dollars demanded.
 - b. The key determinant of net capital outflow is the real interest rate. Thus, as the real exchange rate changes, there will be no change in net capital outflow.
5. We can show the market for foreign-currency exchange graphically.
 - a. The real exchange rate is on the vertical axis; the quantity of dollars exchanged is on the horizontal axis.
 - b. The demand for dollars will be downward sloping because of the inverse relationship between the real exchange rate and the quantity of dollars demanded.
 - c. The supply of dollars will be a vertical line because of the fact that changes in the real exchange rate have no influence on the quantity of dollars supplied.
6. The real exchange rate adjusts to balance the supply and demand for dollars.
 - a. If the real exchange rate were lower than real e^e , the quantity of dollars demanded would be greater than the quantity of dollars supplied and there would be upward pressure on the real exchange rate.
 - b. If the real exchange rate were higher than real e^e , the quantity of dollars demanded would be less than the quantity of dollars supplied and there would be downward pressure on the real exchange rate.

7. At the equilibrium real exchange rate, the demand for dollars to buy net exports exactly balances the supply of dollars to be exchanged into foreign currency to buy assets abroad.

Figure 2 The Market for Foreign-Currency Exchange

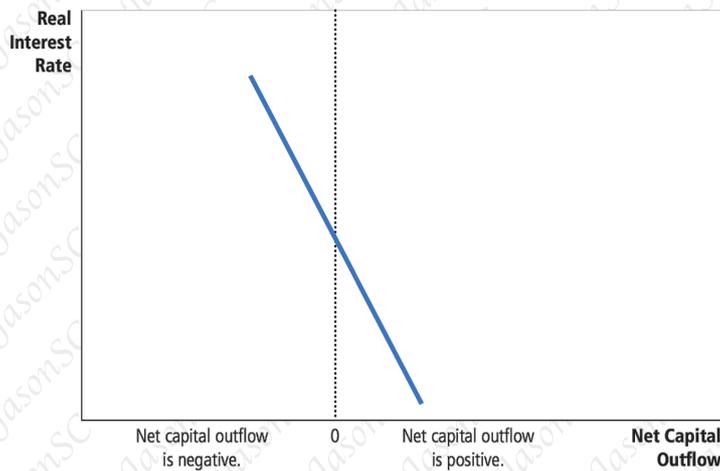


II. Equilibrium in the Open Economy

A. Net Capital Outflow: The Link between the Two Markets

1. In the market for loanable funds, net capital outflow is one of the sources of demand.

Figure 3 How Net Capital Outflow Depends on the Interest Rate



2. In the foreign-currency exchange market, net capital outflow is the source of the supply of dollars.

3. This means that net capital outflow is the variable that links the two markets.

4. The key determinant of net capital outflow is the real interest rate.

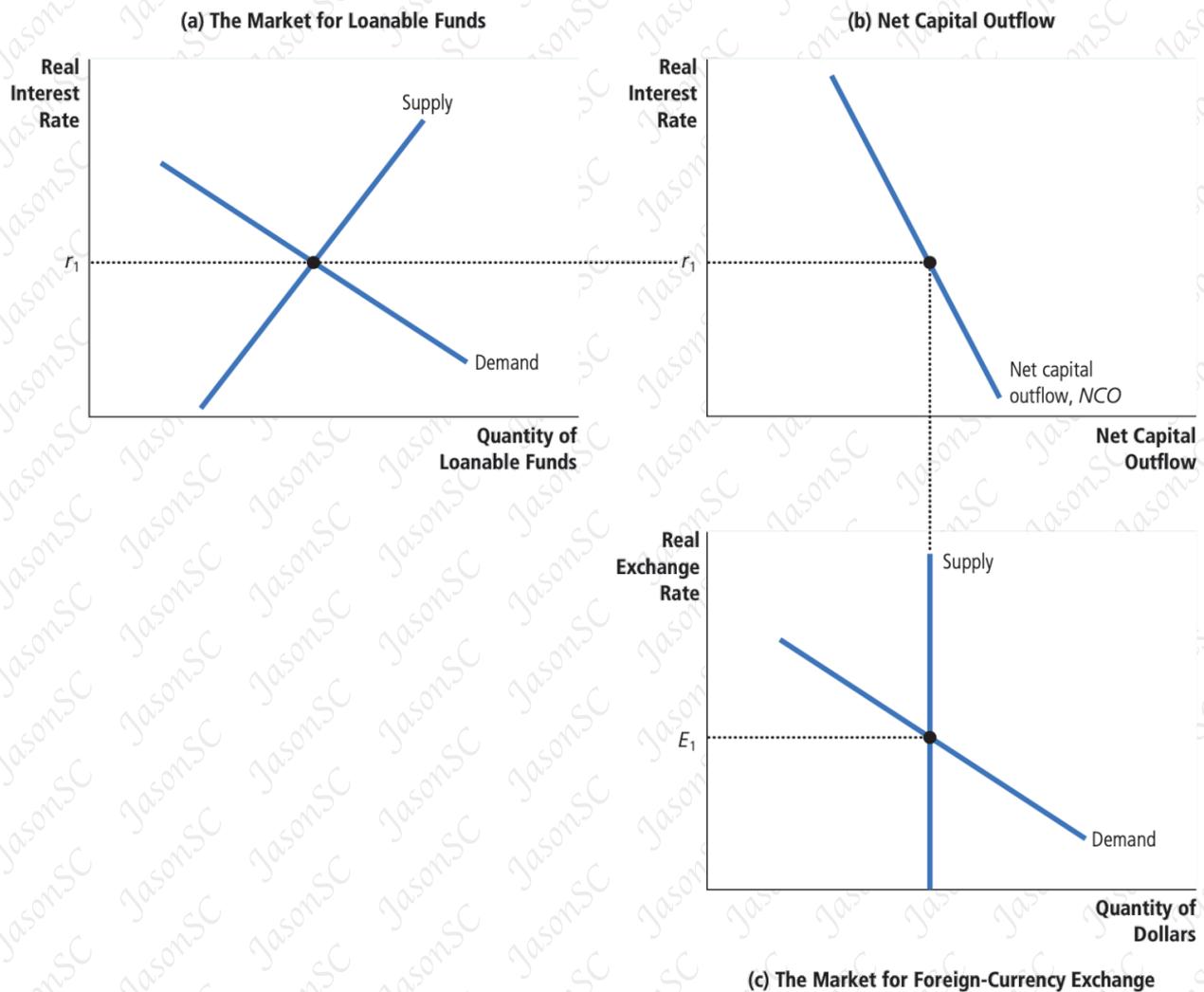
5. We can show the relationship between net capital outflow and the real interest rate graphically.

a. When the real interest rate is high, owning domestic assets is more attractive and thus, net capital outflow is low.

- b. This inverse relationship implies that net capital outflow will be downward sloping.
- c. Note that net capital outflow can be positive or negative.

B. Simultaneous Equilibrium in Two Markets

Figure 4 The Real Equilibrium in an Open Economy



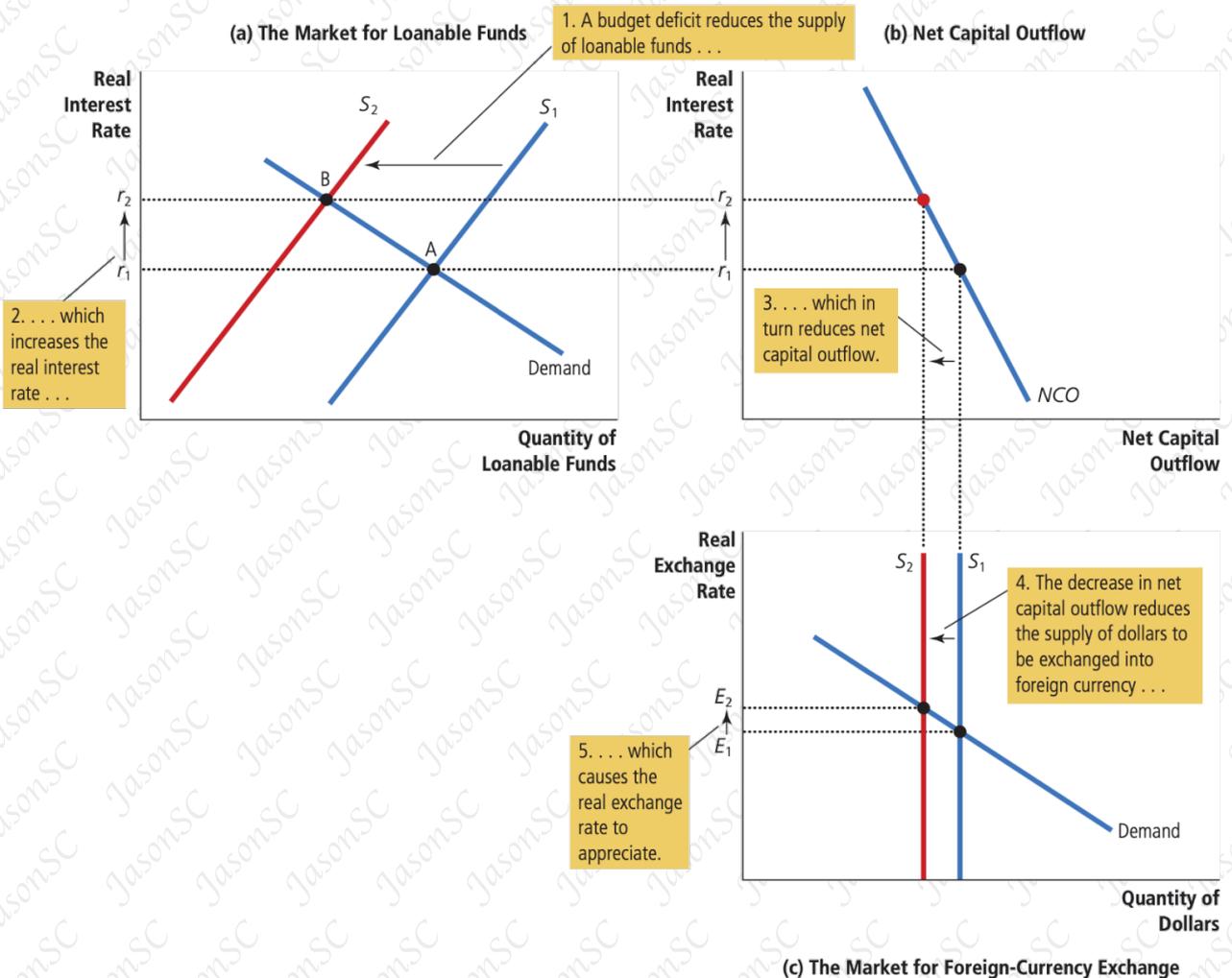
1. The real interest rate is determined in the market for loanable funds.
2. This real interest rate determines the level of net capital outflow.
3. Because net capital outflow must be paid for with foreign currency, the quantity of net capital outflow determines the supply of dollars.
4. The equilibrium real exchange rate brings into balance the quantity of dollars supplied and the quantity of dollars demanded.
5. Thus, the real interest rate and the real exchange rate adjust simultaneously to balance supply and demand in the two markets. As they do so, they determine the levels of national saving, domestic investment, net capital outflow, and net exports.

III. How Policies and Events Affect an Open Economy

A. Government Budget Deficits

1. A government budget deficit occurs when the government spending exceeds government revenue.
2. Because a government deficit represents negative public saving, it reduces national saving. This leads to a decline in the supply of loanable funds.
3. The real interest rate rises, leading to a decline in both domestic investment and net capital outflow.
4. Because net capital outflow falls, people need less foreign currency to buy foreign assets, and therefore supply fewer dollars in the market for foreign-currency exchange.
5. The real exchange rate rises, making U.S. goods more expensive relative to foreign goods. Exports will fall, imports will rise, and net exports will fall.
6. In an open economy, government budget deficits raise real interest rates, crowd out domestic investment, cause the currency to appreciate, and push the trade balance toward deficit.
7. Because they are so closely related, the budget deficit and the trade deficit are often called the twin deficits. Note that because many other factors affect the trade deficit, these "twins" are not identical.

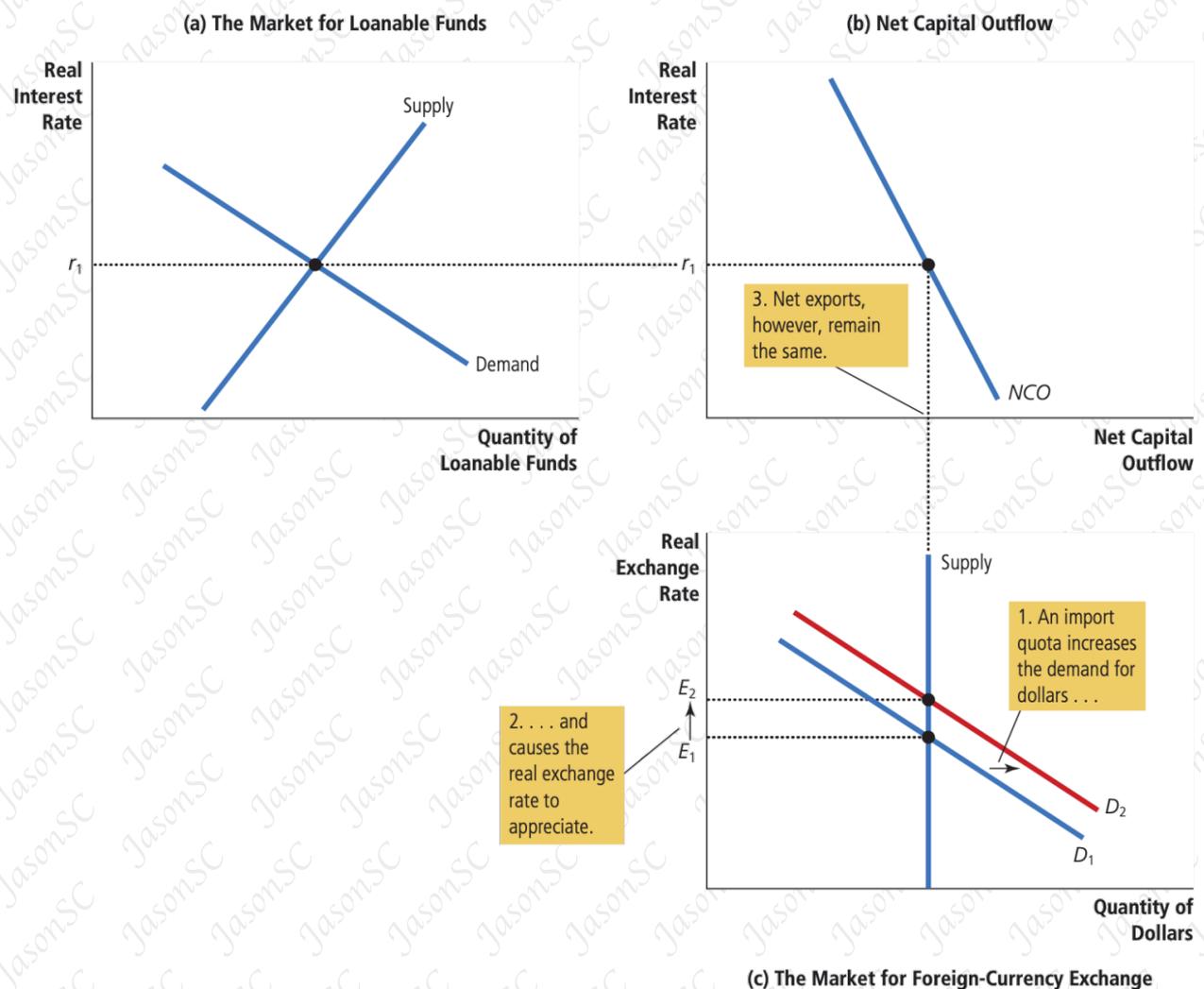
Figure 5 The Effects of a Government Budget Deficit



B. Trade Policy

1. Definition of **trade policy**: a government policy that directly influences the quantity of goods and services that a country imports or exports.
2. Two common types of trade policies are tariffs (taxes on imported goods) and import quotas (limits on the quantity of goods produced abroad that can be sold domestically).
3. Example: The U.S. government imposes a quota on the number of cars imported from Japan.
4. Note that the quota will have no effect on the market for loanable funds. Thus, the real interest rate will be unaffected.
5. The quota will lower imports and thus increase net exports. Because net exports are the source of demand for dollars in the market for foreign-currency exchange, the demand for dollars will increase.
6. The real exchange rate will rise, making U.S. goods relatively more expensive than foreign goods. Exports will fall, imports will rise, and net exports will fall.
7. In the end, the quota reduces both imports and exports but net exports remain the same.

Figure 6 The Effects of an Import Quota



8. Trade policies do not affect the trade balance.
9. Recall that $NX = NCO$. Also remember that $S = I + NCO$.

Rewriting, we get:

$$NCO = S - I.$$

Substituting for NCO, we get:

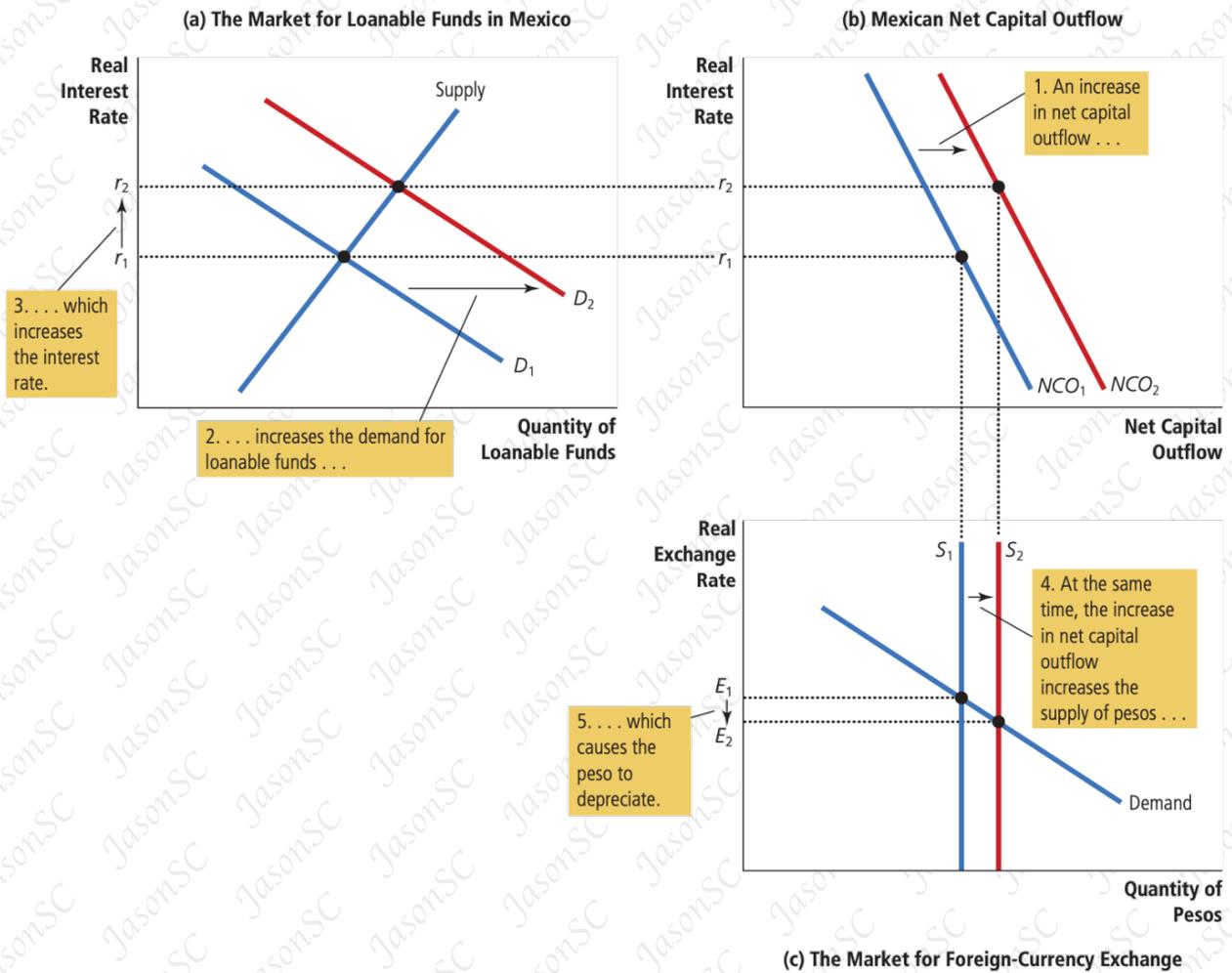
$$NX = S - I.$$

10. Because trade policies do not affect national saving or domestic investment, they cannot affect net exports.
11. Trade policies do have effects on specific firms, industries, and countries. But these effects are more microeconomic than macroeconomic.

C. Political Instability and Capital Flight

1. Definition of **capital flight**: a large and sudden reduction in the demand for assets located in a country.
2. Capital flight often occurs because investors feel that the country is unstable, due to either economic or political problems.
3. Example: Investors around the world observe political problems in Mexico and begin selling Mexican assets and buying assets from other countries that are viewed as safe.
4. Mexican net capital outflow will rise because investors are selling Mexican assets and purchasing assets from other countries.
 - a. Because net capital outflow determines the supply of pesos, the supply of pesos increases.
 - b. Because net capital outflow is also a part of the demand for loanable funds, the demand for loanable funds rises.
5. The increased demand for loanable funds causes the equilibrium real interest rate to rise.
6. The increased supply of pesos lowers the equilibrium real exchange rate.
7. Thus, capital flight from Mexico increases Mexican interest rates and decreases the value of the Mexican peso in the market for foreign-currency exchange.
8. Capital flight in Mexico will also affect other countries. If the capital flows out of Mexico and into the United States, it has the opposite effect on the U.S. economy.
9. In 1997, several Asian countries experienced capital flight. A similar experience occurred in Russia in 1998 and Argentina in 2002.

Figure 7 The Effects of Capital Flight



M3: Capital Flows and the Balance of Payments

I. Balance of Payments Accounts

A. A nation's **balance of payment** measures the exchanges that take place in three separate accounts:

1. **The current account.** Measures the net flow of funds exchanged for goods and services into one nation from all other nations. It also records monetary gifts or grants that flow into or out of a country.
2. **The financial account.** Measures the net flow of funds for investment in real assets (such as factories or office buildings) or financial assets (such as stocks and bonds) into a nation from rest of the world.

B. **The balance of payments (BoP)** will always equal zero when the two accounts above are added together.

1. If a country's current account is in surplus (greater than zero), then its capital account will be in deficit (less than zero).
2. If a country has a current account deficit (less than zero), then its capital account will be positive, and the BoP taken as a whole will equal zero.

II. The Current Account

A. The current account measures the flow of goods, services, and income between the residents of one nation and the residents of other nations.

B. The current account balance is also referred to as the balance of trade. It can be divided into four separate components, outlined below.

C. If the sum of the four components is greater than zero, then a nation has a current account surplus, which means the total income from foreigners' spending on its output is greater than its own spending on foreign output. In other words, that country exports more than it imports. On the other hand, a current account deficit results when residents of a nation spend more on imported goods and services than they earn from their sale of exports to the rest of the world. This is also known as a trade deficit.

D. The measure of net exports (the NX component of aggregate demand) is the same as the current account.

E. The four components of a nation's current account balance are:

1. **Balance of trade in goods.** This measures the spending by consumers and firms in one nation on another nation's goods (both consumer and capital goods) as well as spending by consumers in the rest of world on the recording nation's goods.
2. **Balance of trade in services.** Services refer to non-tangible purchases such as tourism, banking, consulting, legal services, and transportation. Services can be "imported" and "exported," although there will be no physical transportation of a product involved.
3. **Income balance.** The transfer of incomes earned by citizens of one country from activities in another country back to the income earner's country of origin are also measured in the current account. This includes the wage income earned by a country's citizens for employment by foreign companies abroad.

4. Current transfer balance. A transfer refers to a payment made from one nation to another that is not in exchange for any good or service, such as a gift or a grant. Transfers are divided into two categories: official transfers are payments from one government to another, sometimes known as “aid,” and private transfers are payments made by citizens of one country to residents of any other country. Current transfers can be recorded as either a credit or a debit in the current account.

F. When all the credits and debits from each of the components of the current account are added together, they will either equal a positive number or a negative number.

1. A positive current account balance is called **a trade surplus**. If a country has a trade surplus, it means it receives more payments in its current account from the rest of the world than it makes in payments to other countries and that NX is positive.

2. A negative current account balance is called **a trade deficit**. If a country has a trade deficit, it has made more payments for goods, services, income, and transfers to the rest of the world than it has received from abroad and that NX is negative.

III. The Financial Account (formerly known as the Capital Account)

A. The financial account measures the exchanges between a nation and the rest of the world involving ownership of financial and real assets.

B. Foreigners may buy and sell a country’s assets, including real estate, factories, office buildings, and other factors of production. Such transactions are recorded in the financial account because they involve the ownership of assets, not the purchase of the nation’s output of goods or services. Assets purchased in the financial account include things that won’t be brought back to the purchaser’s home country, unlike goods and services.

C. In addition to physical assets, the financial account also measures the exchange of financial assets such as companies’ stocks and government bonds.

D. The financial account measures two types of investments:

1. Direct investment means acquiring a significant ownerships take in a foreign business. Foreign direct investment refers to the buying and selling of a minimum of 10 percent of a company’s shares by a foreign investor in the domestic economy or by a domestic investor in another nation’s economy. Whether direct investment counts as a positive or a negative in the financial account depends on who is buying what.

a. Direct Investments Abroad. Investors from one country may buy or sell ownership stakes in foreign firms.

b. Direct Investments at Home. Foreign investors may buy or sell ownership stakes in domestic firms.

2. Portfolio Investment Abroad. Portfolio investment measures the investments of foreigners in businesses in the domestic economy and domestic investors investing in businesses and government debt abroad. The difference between portfolio investment and foreign direct investment is that, to be considered FDI, the investment must result in a minimum of 10 percent equity ownership in the foreign firm. Equity ownership of less than 10 percent is considered portfolio investment. The recording of these transactions affects the financial account in exactly the same way as for FDI.

a. Portfolio Investment Abroad. The money spent by domestic investors in foreign equity and debt counts as an asset to the investor’s home country and a liability to the foreign country.

- b. Portfolio Investment at Home. The money spent by foreigners on domestic stocks, shares, and bonds counts as a liability for the home country and as an asset to foreigners.
- 3. Other investment usually refers to loans made by banks to foreign borrowers or money saved in banks across national borders.
 - a. Loans from domestic banks to foreign borrowers and savings by domestic households in foreign banks count as assets for the home country, since foreign interests owe money to domestic interests.
 - b. Domestic borrowing from foreign banks and foreign savings in domestic banks are considered liabilities for the home nation, an asset for the foreign nation.

Table 2 The U.S. Balance of Payments in 2008 (billions of dollars)

	Payments from foreigners	Payments to foreigners	Net
1 Sales and purchases of goods and services	\$1,827	\$2,523	-\$696
2 Factor income	765	646	119
3 Transfers	—	—	-128
Current account (1 + 2 + 3)			-705
4 Official asset sales and purchases	487	530	-43
5 Private sales and purchases of assets	47	-534	581
Financial account (4 + 5)			538
Total	—	—	-167