The balance of payments and the international investment position

About black holes, dark matter and sound statistics

Summary

Increasingly, it appears that the development of a country’s international investment position takes place independently of the balance on its current account. It seems that there is a growing mismatch between the statistics on the international investment position and the balance of payments. This thesis seeks to explore the reasons for this trend.

The main research question of this study is stated in Chapter 1 as follows:

*What determines the development of a country’s external asset position?*

A second question is, whether in view of population ageing, it is problematic if countries do not succeed in accumulating a substantial positive net international asset position. Finally, the analysis examines more specifically why the Netherlands, despite decades of having a savings surplus, nevertheless has not managed to acquire a strong external asset position.

In order to address these questions, Chapter 2 first charts the course of the relationship between the balance of payments and the external asset position of countries. This throws up a number of plausible explanations for changes that have taken place in the external asset position, known as wealth effects, which are independent of balance of payments flows.

This cause-and-effect dynamics are further explored in Chapter 3. The explanatory factors can be further divided into a composition effect, a performance effect and a currency effect. The *composition effect* arises if there is a sharp divergence between the composition of gross external assets compared to liabilities. In this respect, the US is a good example, where external liabilities largely consist of low-yielding dollar-denominated bonds, while assets are relatively top-heavy in direct investments and equity holdings. The *performance effect* occurs if within one category, the domestic investment returns deviate from the returns achieved abroad. Finland is a good example of a country where this effect is dominant. The price of Nokia shares appears to provide an important explanation for the development of the country’s net international investment position. This effect can also be seen in the Netherlands. Thirdly, the *currency effect* comes into play if changes in a country’s currency exchange rate lead to a shift in the external asset position. This effect is again clearly evident in the United States. Here, the external liabilities are virtually only denomi-
nated in dollars, whereas foreign assets are held in foreign currencies. Consequently, a weak dollar translates directly into a stronger external asset position.

In Chapter 4, these effects are further illustrated for a group of industrial countries. The analysis shows that the greater the volume of gross external assets and liabilities in relation to GDP, the more important these three effects are relative to the importance of the position of the current account of the balance of payments.

Chapters 6 and 5 illustrate cases of two countries that can be seen as extreme examples in this respect. The first is the Netherlands, a case study of the 'black hole', followed by the US, a case study of 'dark matter'. For both countries, the perceived gap between cumulative current account balance and the development of the international investment position can be satisfactorily explained by the three effects referred to above. For neither of these countries is there a need to resort to the excuse of 'poor statistics'; nor, in the case of the US is it necessary to invoke voodoo economics in the form of 'dark matter'. The analysis also examines what the consequences of the US debt position may be for the role of the dollar. For the Netherlands, the analysis in Chapter 6 produces the sobering and inescapable conclusion that there is no pot of money out there somewhere that the statisticians have somehow overlooked when compiling a list of the country’s assets.

In Chapter 7, the wealth effects are integrated into a new balance of payments classification, producing a balance of payments statement corrected for wealth effects. This new classification, to be used alongside the usual balance of payments statistics, gives a different perspective of the international balance of payments imbalances, and therefore provides useful additional information for stakeholders and policymakers.

Chapter 8, finally, contains a summary and a number of conclusions. This chapter also addresses the question whether in view of population ageing it is problematic if countries do not succeed in accumulating a considerable positive net international asset position. In general, it can be asserted that a country is better off, as in the case of the Netherlands, to build up a solid, fully funded pension system. Whether this may lead to a net international asset position is not very relevant.

The concluding remarks are firstly that we should dismiss the balance on the current account as a variable in policy-making. Secondly, the Netherlands should consider how to deal with its weak external asset position. The question to be answered in this respect is how this country can prevent the loss of its control over strategic companies and sectors. Finally, it is concluded that this country can only continue to exert influence on the game plan for the process of globalisation in the coming decades, by doing so in the context of a strong European Union.

(translated by Roisin De Jong)