

COMMENT & ANALYSIS: America's deficit, the world's problem  
By Richard Clarida  
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Once again, the US trade deficit is in the news. The latest figures, released on Friday, show that the deficit expanded to a record \$38.5bn (£24.8bn) in August as Americans continued to consume foreign goods and services. The size of the deficit was increased by the rising price of oil imports.

It is clear from the evidence that the US current account reflects a lack of growth, and growth prospects, in much of the rest of the world. Moreover, the present deficit in the US current account does not suggest that a change in current US economic policy is warranted. Nor would it be welcomed by the rest of the world.

As a matter of national income accounting, the US current account is simply the difference between national saving and investment and is equal to the net accumulation of US assets - portfolio and direct - by foreign investors. A deficit is not necessarily bad, nor is a surplus necessarily good. This is because the US has a floating exchange rate and is well integrated into the global capital market. It can finance its current-account deficit in this capital market by selling equities, private debts and government bonds - all denominated in dollars - without having to draw down international reserves or incur foreign-currency obligations.

According to official estimates, as a result of the current account deficits in the 1980s the US became a net foreign debtor in late 1988. Since then, it has accumulated a stock of net foreign liabilities exceeding \$2,000bn - equivalent to 20 per cent of US gross domestic product. According to the national income accounts, in 2000 the cost of servicing this foreign debt (almost all of which is denominated in dollars) was only \$12.1bn dollars - 0.6 percentage points of the estimated outstanding balance.

Why is the cost of servicing the debt so low? The most commonly offered explanation derives from the fact that US direct investments abroad are consistently much more profitable than foreign direct investments in the US. In 2000, for example, the estimated market value of US direct investments abroad was \$2,500bn, compared with the market value of foreign direct investment in the US of \$2,700bn. Yet the receipts of direct investment income from current production of foreign affiliates of US companies in that year was \$132bn, compared with payments to foreign owners of US-located investments of only \$37bn.

The best way to interpret the present US current account deficit is as follows. There is a pool of portfolio capital in the world that has fewer places in which to invest than several years ago and that capital is seeking safety and acceptable returns in the US. Portfolio capital is not flowing to emerging markets as it did in the mid 1990s.

Europe faces long-standing structural challenges (high unemployment, sluggish growth) that have not gone away in spite of the successful launch of the euro. Japan is entering its second decade of economic contraction and continuing fiscal and financial difficulties. Given this background, it is hardly surprising that capital is flowing into the US because of the relatively superior performance and prospects for growth in the US economy. This process has been reinforced by the strong productivity statistics in the US during the recession last year, which have confirmed the earlier bet by the markets on the durability of the productivity rebound first observed in the 1990s.

Of course, over time we would hope to see in Europe lower unemployment and faster growth approaching US rates. We certainly hope that Japan will at last begin to resolve its structural problems and resume growth, investment and prosperity. We aim, working with the Group of Seven industrialised countries, to put in place a framework in the international capital markets that will make more emerging markets attractive destinations for portfolio capital flows.

All of these developments would be most welcome. We understand that, were they to occur, the US would benefit significantly. Exports would surge, some of the growing pool of world capital that would otherwise flow to the US would be attracted abroad and the US current account deficit would narrow. There is every reason to expect - as US history suggests - that this adjustment would be accomplished in the global capital markets in an orderly fashion.

In sum, the US current account is caused, in large part, by a deficit of growth in the rest of the world. The growth deficit is of course not desirable but, as long as it persists, foreign capital flows to the US, and thus the US current account, will adjust to bring global saving and investment into balance.

In particular, the present deficit in the current account does not suggest that a change in US economic policy - one that would attempt to narrow the current-account deficit by slowing US growth - is appropriate. And it would not be desirable for the rest of the world at this time.

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