THE GUEST WORD

The US Trade Deficit: A Cause for Alarm?

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Is the recent deterioration of the US trade deficit a cause for alarm? My own view is that the dangers of the situation are easily exaggerated. That our deficit is large—exceptionally large—is certainly evident. Never before in this country's history has there been such a massive gap between our exports and our imports. Indeed, until as late as 1971-72, we had never in this century even experienced a negative trade balance. In 1973, largely as a result of two devaluations of the dollar, we were back in surplus again; and after an oil-induced deficit in 1974, we enjoyed another surplus in 1975. In 1976 the deficit was only about $5 billion. Last year, by contrast, the deficit was $27.6 billion, and a comparable excess of imports over exports is expected for this year as well.

Large as these figures are, however, they do not warrant a panicky revision of current US policies, despite recent turbulence involving the dollar in the foreign-exchange market. Most of the deterioration of our trade balance since 1975 is attributable to quite special factors, such as the recent wave of good harvests around the world, sharply reducing American agricultural exports in both volume and price, and the continuing increase of our dependence on foreign energy sources. Oil imports in 1977 topped $44 billion, up more than $10 billion from a year earlier.

One special factor of particular importance has been the difference in timing of cyclical developments in the United States and its major trading partners. Economic recovery from the recession of 1974-75 not only began earlier in the United States than elsewhere but also has been more sustained and vigorous. In

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most other industrial economies, growth rates are still substantially below those typically achieved during the years prior to the 1974-75 recession. Expansion of real output in the 24 member-countries of the OECD in 1977 was only 3½ percent, down from 5¼ percent in 1976. Performance in the largest of the industrial economies was particularly disappointing. In Britain, France, and Italy, real expansion was virtually nil; in Canada, Germany, and Japan, it was well below what had been hoped. Only in the United States was there any marked buoyance in the growth of output and final demand (topping 5 percent for the year as a whole). And this of course is what accounted for a very large part of the increase of our trade deficit. Inventory building and increases in personal consumption expenditures at home stimulated demand for imports of industrial materials and consumer goods (as well as fuels), while US exports, particularly of capital equipment, were severely hampered by the weakness of investment demand abroad. But for such differences in conjunctural (medium term) conditions here and abroad, our deficit would have been far smaller than it actually turned out to be.

A second reason for taking a relatively more sanguine view of the present deficit is that it is in fact *needed*. From a global macroeconomic point of view, the deficit is decidedly a Good Thing. The counterpart of continuing current surplus among the OPEC group of countries must be a collective deficit for the rest of the world. This deficit cannot be avoided: it can only be shared. And if a large part is not shared by the world's strongest national economy, proportionately more must fall instead on weaker economies, some of which may no longer be either able or willing to carry such a heavy burden.

Already many oil-consuming countries have built up a crushing burden of external debt in financing their oil-induced deficits since 1973. Many others have avoided substantial cumulative deficits abroad only by severely suppressing their growth rates of real output and final demand at home. Dissatisfaction with both these unpleasant policy options is growing; and in the search for alternative policy instruments that would enable them to avoid both additional foreign debt and continued domestic stagnation in the future, foreign governments increasingly seem to be looking toward the escapist solution of protectionist trade measures of various kinds, including competitive depreciations of exchange rates. This is a very real and present danger to the liberal international economic order, and it can be forestalled only if the world's strongest national economies relieve some of the pressures on weaker countries by assuming a larger share of the oil-consumers' collective deficit. This, in effect, is what the United States is doing. Far from threatening America's ability to exercise continuing economic leadership in the world, the deficit in fact consitítues the very essence of economic leadership in present circumstances. America's deficit helps to keep the world away from the slippery slope of commercial protectionism and competitive depreciations.

Does that mean, then, that we can afford merely to stand pat? Not at all. These are not times for complacency (least of all in the energy field, where our growing dependence on foreign oil is clear evidence of the need for an effective domestic energy policy). I am not advocating a policy of benign neglect. Quite the contrary, in fact. For even if it is true that the present trade deficit signifies no serious deterioration of our competitiveness in international markets, the deficit remains—and because of that deficit the fact remains as well that we are facing here at home a groundswell of protectionist pressures in many of our own exporting and import-competing industries, from shoes and textiles to electronics and specialty steels. These protectionist pressures must be resisted. How?

In my opinion, they can best be resisted by persuading other strong national economies to shoulder a larger share of the collective deficit of oil consumers. This means, in particular, the two so-called "locomotive" economies of Germany and Japan, both of which in fact have lately been running surpluses rather than deficits on current account. In 1977, the German current surplus approached $2½ billion; the Japanese, a whopping $11 billion. Both surpluses were perverse from a global macroeconomic point of view. Both directly reflected relatively sluggish growth performance in these two economies. As Carter Administration spokesmen have repeatedly pointed out (to fierce German and Japanese objections), what is obviously needed is more direct demand stimulation in both countries to help encourage additional purchases from outside their own frontiers (including the United States). One effect of accelerated expansion in Germany and Japan, apart from the growth stimulus provided to other weaker economies, would almost certainly be to reduce the trade deficit of the United States by narrowing the disparity between us and them in conjunctural conditions. Promotion of reflation in their two economies therefore is the key to defusing our own problem of swelling protectionist pressures.

Of course, one might ask: why rely so heavily on differential demand-management policies? Why not rely on a differential movement of exchange rates instead, via either appreciation of the mark and yen or depreciation of the dollar? The answer is: because this seems to be the way the adjustment process works. According to recent studies by the IMF and the OECD, such adjustment of trade balances as has occurred among industrial countries in recent years has been almost entirely due to differential movements of real domestic demand. Although nominal exchange rates have varied considerably since 1973, their changes have been confined mainly to off-setting—or being offset by—domestic cost and price inflation, with relatively few lasting effects on trade account. "Real" exchange-rate movements, in the sense of sustained shifts in relative cost-price positions, have been comparatively small. This suggests that it is best to focus directly on real output and final demand in each

economy, rather than on the nominal exchange rates of currencies, if the pattern of current-account deficits among countries is to be genuinely affected on a lasting basis. And that pattern must be affected if the liberal international economic order is to continue to be viable in present circumstances.