BLESSING OR CURSE?

by Robert Z. Lawrence

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The East Asian Crisis and America's Trade Deficit

The East Asian financial crisis is certain to leave its mark on America's trade balance. The Organization for Economic Cooperation and Development projects that over the next two years the broadest measure of the U.S.trade deficit—the current account balance, which includes trade in goods and services, net factor incomes, and unilateral transfers—will grow by some $100 billion dollars. The deficit in goods trade alone will grow to exceed $300 billion. Such projections have been greeted with alarm, especially with last year's current account deficit of $166 billion already approaching record levels. The growing trade deficits are likely to make it even harder for the Clinton administration to get "fast-track" authority

Table 1. U.S. NET NATIONAL SAVING AND INVESTMENT
(As a percent of net national product)

	Net National Saving		Net National Investment		Employment
	Private	Government	Domestic investment	Net foreign investment, or current account	(millions)
1981	9.7	-0.1	9.9	0.3	100.4
1987	6.7	-1.1	9.0	-3.8	112.4
1991	7.2	-2.3	4.9	0.1	117.7
1997	6.2	1.1	8.3	-2.2	129.6
Change					
1987/81	**-3.0**	**-1.0**	**-0.9**	**-4.1**	**12.0**
1997/91	**-1.0**	**3.4**	**3.4**	**-2.3**	**11.9**

Source: Economic Report of the President, tables B-32 and B-36; Survey of Current Business.

Over time, the depressed real exchange rates will also stimulate their exports. The OECD expects the current account of the affected countries to increase $70 billion by 1999.

The counterpart to the Asian surplus must be larger current account deficits (or smaller surpluses) elsewhere. If the Asians draw less on the global pool of savings, other countries should draw more to prevent a global downward spiral into recession. A big part of the adjustment will take place in the United States, in part because Asian currencies have all declined against the dollar and in part because U.S. growth remains robust.

Many Americans complain that the United States is being called on to do more than its fair share. Why should America be the global borrower of last resort? Americans particularly blame Japan, and to a lesser extent Europe, both of which lend more to Asia and yet are being expected to play much smaller roles in countering the East Asian shift toward surplus. The assumption behind this view, of course, is that trade deficits are necessarily bad—and the assumption is so ingrained that we commonly describe a movement toward larger trade deficits as a "deterioration," a movement toward surplus as an "improvement."

Trade deficits are seen as bad for two reasons. First, they are supposed to cost jobs. In 1996, each $1 billion value-added in U.S. manufacturing was associated with 14,000 jobs. People often extrapolate from such numbers to conclude that an additional trade deficit of $100 billion must entail the loss of 1.4 million

to negotiate further trade liberalization. They could even increase protectionist pressures within the United States.

But the conviction that large trade deficits must be a problem merits a closer look. Efforts to lower the trade deficit by erecting new barriers to the U.S. market could in fact be disastrous. Both the world and the United States could be much better off if the deficit is allowed to grow.

The key is understanding the central role of the U.S. trade deficit in stabilizing the world economy. Today, a big challenge for the countries of East Asia is restoring international creditworthiness. Whatever the reasons for their problems, the questions raised about all their financial systems will make it harder for them to borrow in the immediate future. One result of the crisis has been to shift trade balances in these countries toward surplus. As their currencies have plunged, and their growth rates fallen, imports have plummeted.

jobs. Second, trade deficits are supposed to lead to greater international liabilities. It is imprudent for the United States, already the world's largest net debtor country, to borrow more because the obligations will have to be either serviced or repaid.

To see how these concerns could be wrong, it is necessary to remember that there are three equivalent definitions of the current account. The most common and obvious is that the current account is equal to the difference between exports of goods, services, and gifts *to* foreigners and imports of goods, services, and gifts *from* foreigners. If the United States has a deficit, it will be buying more from foreigners than they buy from it. But according to the second definition, the current account must also be equal to the difference between national income and spending. If the United States has a current account deficit, its national spending (on both consumption and investment) exceeds its income and it must either be borrowing from foreigners or selling off foreign assets. By the third definition, the current account equals the difference between national saving and investment. If the United States has a current account deficit, its domestic investing exceeds national saving (the sum of private saving and government saving—or deficits).

Recognizing that the current account equals the difference between income and spending is useful in thinking about the links between the current account and employment. The current account will be in deficit as long as spending exceeds income. But that deficit could occur in the face of very different spending and investment levels. Those who believe that trade deficits necessarily mean a drop in employment have in mind a current account deficit in which income (and thus employment) is falling faster than spending. But what if spending exceeds income and yet both are *rising*? In other words, the current account deficit and employment could both be growing!

Recognizing that the current account equals the difference between national investment and saving is useful in thinking about the links between the current account deficit and international indebtedness. Is it good or bad to get into debt? It depends on what you are doing with the money. A current account will be in deficit as long as investment exceeds saving. But that deficit could be associated with very different levels of saving and investment. Those who believe that increased international indebtedness reduces future incomes have in mind a current account deficit in which domestic saving falls and the country is borrowing to consume. But what if productive domestic investment is boosted by international borrowing? In that way, a current account deficit could raise future incomes.

A TALE OF TWO CURRENT ACCOUNT DEFICITS

These observations are not simply theoretical niceties, as table 1 makes clear. The table compares two recent episodes (1981–87 and 1991–97) in which the U.S. current account moved from surplus to deficit—in both cases, to a deficit of around $170 billion.

Strikingly, employment expanded strongly during both episodes. In both the 80s and the 90s, as the U.S. economy recovered, spending increased more rapidly than production. Basically, in both periods, the trade deficit reflected the strength of U.S. spending, rather than a fall in incomes. Americans were buying more, both from U.S. producers and from producers abroad. During the years between the two periods, by contrast, when the economy fell into recession, unemployment grew and the current account deficit shrank—implying that U.S. spending fell faster than income.

What about the rise in U.S. international indebtedness? Was the United States borrowing to offset less domestic saving or to finance more domestic investment? In this respect the deficits of the 80s and the 90s are quite different.

In the 80s, the current account deficit clearly reflected a saving bust. The familiar part of this story is the rise of the government deficit, which grew by 1 percent of NNP between 1981 and 1987. Less familiar, perhaps, but even more important quantitatively was the plunge in the private saving rate by a full 3 percentage points of NNP. There clearly was no investment boom. Net domestic investment as a percentage of NNP fell by 0.9 percentage point. Thus the foreign borrowing appears not to have been devoted to income-raising investments.

In the 90s, the spending patterns driving

the deficit have shown noticeable differences. Most striking are the dramatic increases in net national saving (because of the declining federal government deficit) and in net domestic investment. This trade deficit looks more like an investment boom than a saving bust, which may help explain why it has not given rise to as much concern.

Enthusiasm for the performance in the 90s should be tempered by awareness that—perhaps in response to the dramatic rise in national wealth due to the booming stock market—personal saving has continued to fall (from 5 percent to 3.1 percent of NNP). And both net national saving and net national investment remain much lower shares of NNP than they averaged in the 1960s and 1970s. Nonetheless, these data underscore the central point that current account deficits are not always reasons for concern. First, as long as income (and thus production) is growing strongly there need be no rise in overall unemployment even if spending is growing faster than income. And, second, as long as spending falls heavily on productive investment there need be no concern over the rise in international indebtedness.

The key to ensuring that the current account deficit that is emerging in response to the Asian crisis is benign, therefore, is generating strong investment growth in the United States. The lower long-term interest rates and strong stock market in early 1998 should help. As long as the economy can absorb additional resources without inflation through the current account, the Federal Reserve can avoid raising interest rates.

This does not mean that no Americans will lose jobs to Asian competition. While growth in U.S. spending will spur demand for workers both at home and abroad, some expenditure-switching will mean that foreign goods are bought and domestic goods are not. In particular, manufacturing could see some painful adjustments. The best chance for these workers is finding work in other parts of an economy in which growth is robust. As Robert Litan, Gary Burtless, Robert Shapiro, and I have described in our book *Globaphobia: Confronting Fears about Open Trade*, training and adjustment assistance could also be improved.

But the bottom line is this: if domestic saving is too low to fund profitable investment opportunities in the United States, we are better off borrowing from abroad and running a deficit than avoiding the deficit and losing the opportunity to improve our well-being. If the prospects for investment in the United States are (temporarily) better than those in Asia, a larger U.S. current account deficit may be necessary to maintain not only global incomes but also a desirable allocation of global resources.

Over the long run, of course, U.S. incomes would be even higher if we save the money ourselves, rather than borrowing it from foreigners. The best way to reduce our current account is not to cut down on investment but to raise national saving. Given how hard it has been to design effective policies to stimulate private saving, it might be desirable for the federal government to run budget surpluses in the years to come. ■