20. The Principal Global Imbalance Lies Elsewhere

NUMEROUS COMMENTATORS, including economists as well as pundits, both in the United States and abroad, vie with one another in proclaiming the unsustainability of the U.S. current account deficit—the excess of U.S. payments for imports of goods and services, over revenues from corresponding exports. They then often criticize America's unilateralism for ignoring this imbalance, combining the criticism with warnings that continued neglect may trigger a global depression if and when other countries choose to discontinue their willingness to accept dollar assets in compensation for the U.S. current account deficit. If, instead, the foreign holders of these dollar assets decide to liquidate some of them, then a drastic collapse in the dollar's value and a worldwide depression may ensue.

In fact such a dire result is unlikely; the analytic underpinnings of the argument are flawed. A modest rebalancing of the U.S. current account deficit poses a much less difficult challenge for the economy and society of the United States than for those of several other key players in the global economy.

The U.S. current account deficit in 2004 reached an all-time high in dollar terms (approximately $650 billion); as a share of

U.S. GDP the deficit of 5.5 percent is the highest share in the past decade. Since 1995 the current account deficit has risen gradually, from 1.5 percent in 1995 to the 2004 share of 5.5 percent. In only one year of the decade, between 2000 and 2001, did the current account deficit shrink as a share of GDP; the biggest jump in the deficit's share of GDP occurred not in 2004 but in the year 2000, when the deficit's share of GDP rose by a full percentage point. This was a year when the GDP growth rate in the American economy was just below 6 percent. As a general rule, as the U.S. economy grows more rapidly than most of its trading partners, so also does the U.S. current account deficit grow.

Not infrequently, commentators in both the United States and abroad often delight in characterizing these deficits as "profligate American spending" (in the words of British economist professor Robert Skidelsky). In fact, the way national accounts are estimated, the U.S. current account deficit is precisely equal to the excess of gross domestic investment in the U.S. over domestic savings; conversely, current account surpluses that are maintained by other key economies reflect a deficiency of domestic investment in these countries relative to their domestic savings. Thus, the U.S. deficit could be reduced either by raising domestic savings or by lowering investment or a combination of the two; conversely, the current account surpluses of other countries could be modulated by raising investment or/and lowering savings.

It's worth emphasizing that the generally buoyant level of investment in the United States, which underlies the current account deficit, is in part responsible for the strong performance of the American economy relative to all other major industrial economies. In particular, high U.S. investment has fed a sustained rise in U.S. labor productivity and therefore of rising wages over the past decade.

The U.S. current account deficit is mirrored by current account surpluses in other countries. Specifically, the multilateral current account surpluses of four other countries represent nearly 60 percent of the global U.S. current account deficit. These four other countries are Japan, with a current account surplus of nearly $170 billion in 2004; Germany, with a surplus of more than $100 billion; Russia, with more than $90 billion in surplus; and China, with $46 billion surplus. If the U.S. current account deficit were to shrink in the next few years, the indirect multilateral consequence would be that these countries will have to import more or export less and to invest more at home and/or save less than they currently do.

A modest rebalancing of the U.S. current account deficit would be more comfortable and is more likely than would be the implied adjustments in the four major current account surplus economies. Several prospective changes in the U.S. economy are likely to point in this direction. An uptick in U.S. household savings is likely to ensue from several recent macroeconomic trends: for example, the emergence of health savings accounts in the health-care sector; the possibility of personal savings accounts as add-ons to Social Security accounts; and, perhaps even more significant, the spreading belief among the younger cohorts of the U.S. labor force that Social Security benefits may be reduced in the future, thereby generating stronger incentives among younger workers to save more themselves outside the Social Security framework.

On the other hand, prospects for the adjustments in the economies of the four surplus countries that would facilitate the U.S. rebalancing are more dubious, and their corresponding macroeconomic policies to move in this direction are more nebulous. Whether and how Japan, with a recent lapse in its low GDP growth rate, Germany, with a near-stagnant economy and a 10.5 percent unemployment rate, and Russia, much of whose 6.7 percent impressive GDP growth rate has been due to its oil-dependent export surplus, can make the necessary adjustments in their respective economies is considerably more problematic than are the requisite adjustments in the American economy. Indeed, among the four principal surplus countries, China is probably best situated to lower its current account surpluses in the next few years.

Ironically, even modest rebalancing of the U.S. current account deficit is likely to impose less of a challenge to the American economy than to the economies of other countries that have excessively relied on current account surpluses to either avoid stagnation (Japan and Germany) or to generate high economic growth (Russia and China).

POSTAUDIT

I continue to believe that the American economy can more readily adjust to a reduction in its large current account deficits than the four surplus countries can adjust to reductions in their surpluses. None of the changes anticipated in this piece, however—for example, a rise in U.S. household savings, slower U.S. growth or, indeed, a diminution in the U.S. current account deficit—has yet occurred, so the grade for this piece should be lowered.