

# **Dilemmas and Risks of the Current Account Deficit in the U.S.A.**

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# Presentation structure

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- Development of Current Account deficit: the last 15 years.
- Consequences and risks for the American economy.
- Consequences and risks for the World Economy.
- Dilemmas for correcting the American external unbalance.

# Development of Current Account deficit : the last 15 years

## Deficit deterioration context

### *Favorable economic performance in the 90's:*

- Accelerated increase of private consumption expenses, based on a high private indebtedness and a reduction of the saving rate.
- Increase of the gross investment.
- Dollar appreciation.
- Favorable fiscal situation.

### *2000- 2005:*

- Fiscal stimulus (tax reduction, growing public expenses, mainly military expenses).
- Monetary stimulus (reduction of the interest rate).
- Saving-rate reduction (mainly public one).
- Dollar depreciation 2002- 2004.

# Development of Current Account deficit: the last 15 years

## Factors

- Domestic investment levels higher than saving levels.
- Growth differential between United States and its main trading partners.
- Dollar appreciation (1995- beginning of 2002).
- Increase of oil's international prices .



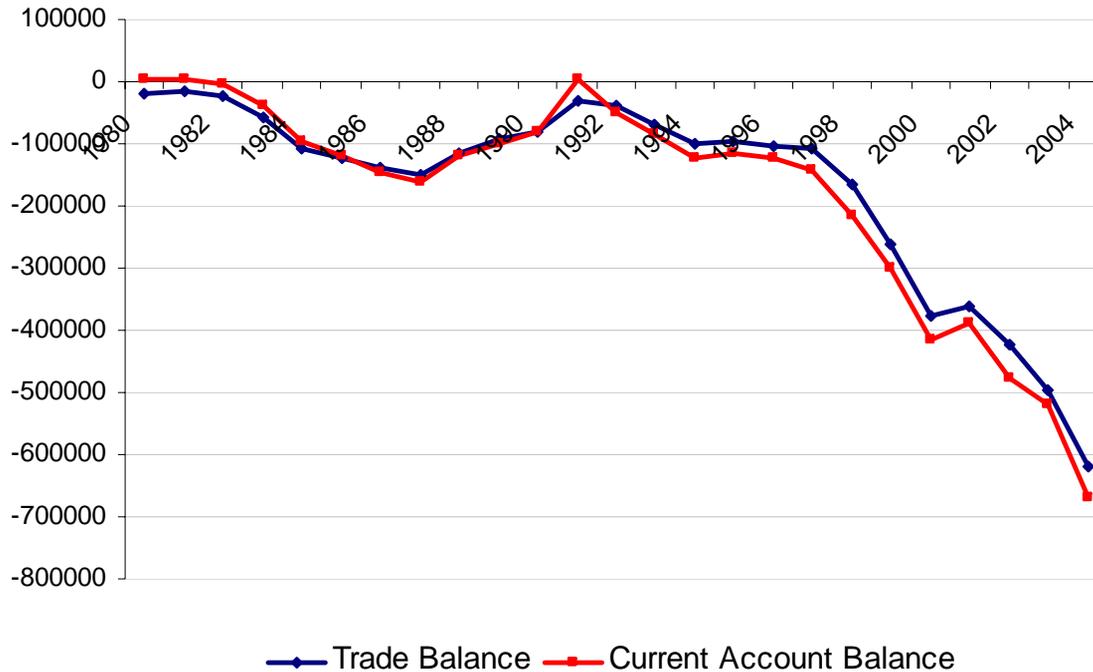
**Trade deficit deterioration**



**Current Account deficit deterioration**

# Development of Current Account deficit: the last 15 years

**Graphic 1. Trade Balance and Current Account Balance, 1980-2004  
(Million of dollars)**



Source: Created by the authors up from Bureau of Economic Analysis data, <http://www.bea.org>.

# Consequences and risks for the American economy.

- **Growing dependence from the external financing to finance the growth.**

Net International Investment Position (N.I.I.P.) deterioration,  
future costs of debt service

- **Foreign investors' loss of confidence.**

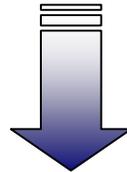
Depreciation → interest rate increase →  
growth reduction

- **Changes in employment and income's distribution.**
- **Protecting pressures reinforcement.**

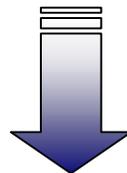
Unencouraging imports, affected sectors protection

# Consequences and risks for the world economy

**The United States** absorbs with its Current Account deficit, about **70% of the external surplus** from Japan, Germany, China and the other surplus countries.

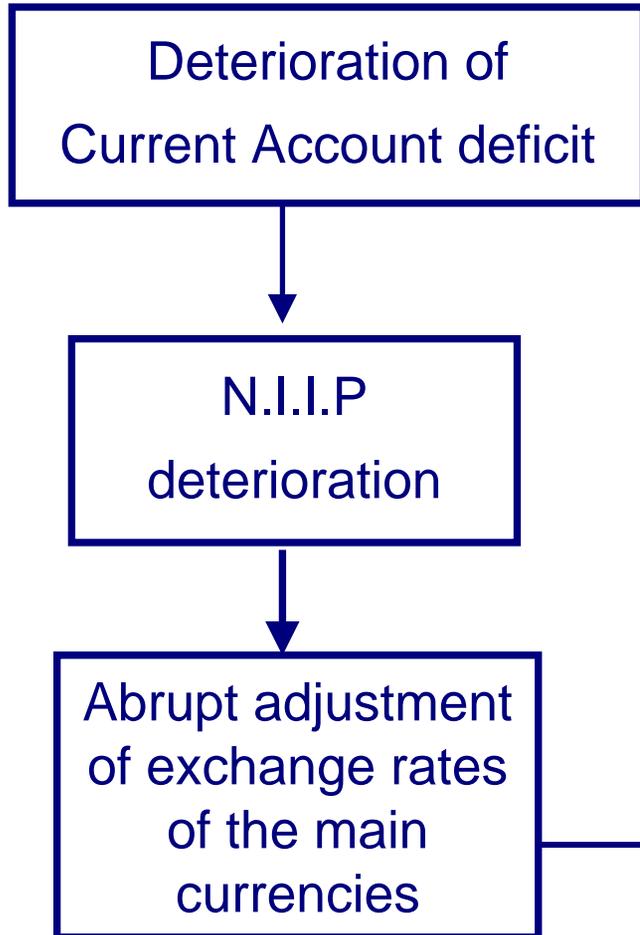


United States' dependence from external saving and dependence of the rest of the world from net exports to the United States.



**Global interdependence**

# Consequences and risks for the world economy.



- **Automatic appreciation** of other currencies.
- **Instability** in financial markets.
- Global **interest rate growth**.
- **Affectation** to the main U.S.A. **creditors** or those keeping the biggest part of their **reserves** in dollars.
- **Competitiveness** decrease of foreign enterprises.
- Reinforcement of **protecting measures** outside of the U.S.A.
- **Deceleration** of global **growth**.

# Consequences and risks for the world economy.

## Underdeveloped countries: potential risks

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graph TD; A[Underdeveloped countries: potential risks] --> B[Dollar depreciation:]; A --> C[Financial instability:]; A --> D[Interest rates growth:];
```

### Dollar depreciation:

- Decrease of debt stock's value denominated in dollars.
- Capital losses due to the decrease of reserves' values.

### Financial instability:

- It would influence negatively on investors' expectations, increase yield spreads, decrease sovereign credit ratings.

### Interest rates growth:

- The cost service of the debt based on variable interest rates would increase.
- The access to new financing will be limited due to its cost increase.

# Consequences and risks for the world economy.

## Underdeveloped countries: potential risks

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graph TD; A[Underdeveloped countries: potential risks] --> B[Currency appreciation:]; A --> C[World economic deceleration:]; A --> D[Protectionism:];
```

### Currency appreciation:

- Loss of exports competitiveness.

### World economic deceleration:

- It would affect the demand of its exportable products.
- It may negatively influence on the prices of some basic products.

### Protectionism:

- It would limit the growth rhythm of the exporting sector.

# Dilemmas for correcting the U.S.A. external unbalance

## *Current Account Deficit Perspectives*

**2006:** 6,5% of PIB

**2008:** 7,8% of PIB (Roubini & Setser)

## Correction of the external unbalances

### **1. Adjustment of the exchange rate of the main currencies.**

- Dollar depreciation since February, 2002.

### ***Factors that inhibited depreciation:***

- Mass interventions mainly from Asian governments in foreign exchange markets.
- 2005: Short-term interest rate growth in the U.S.A. and long-term interest rate reduction in Europe.

## Dilemmas for correcting the U.S.A. external unbalance

¿Why the sustained depreciation for more than two years did not induce any improvement of the Current Account deficit?

- Time-lag between depreciation and exportations' increasing effect (*J curve*).
- The sustained dollar appreciation in previous years may have introduced relatively-permanent changes in U.S.A. trading patterns, making the correction of external unbalances more complex (*hysteresis effects* ).
- There has been *poor pass-through* of dollar depreciation to U.S.A. imports' prices, because of deliberate action of exporters to American market in order to keep their competitiveness.
- *Others*: Higher growth in the United States than abroad and increase of oil's prices.

# Dilemmas for correcting the U.S.A. external unbalance

## Correction of external unbalances

- **Global demand adjustment** by establishing economic policies in U.S.A. and the rest of the world which reduces:
  - American dependence from external saving and
  - External dependence from net exports to U.S.A.

# Dilemmas for correcting the U.S.A. external unbalance

## *Policy proposals of the main international organizations*

### *U.S.A.:*

- To decrease the national demand and promote saving.
- Fiscal consolidation.
- Restricting monetary policy.

### *Japan and Europe:*

- To boost potential growth and demand.
- To accelerate structural reforms.
- Labor market flexibility.
- Introducing competition in protected sectors.
- Public enterprises reform.

### *Asia's underdeveloped economies:*

- To make exchange-rate regimes flexible.

**DILEMMAS**

# Dilemmas for correcting the U.S.A. external unbalance

## **U.S.A.:**

- The steps that have been taken to fiscal consolidation are due to an unprecedented reduction of the social-significance expenses, without affecting the growing military expenses.

## **Europe:**

- The proposed structural reforms are aimed at the erosion of the already weakened European Welfare State.
- The Stability Pact's strict standards in the fiscal level collide with the economical expansion possibilities in the European Union.

## **Japan:**

- Going deep into the structural reforms might reinforce the deflation condition and extend the economic stagnation.
- The critical fiscal situation constitutes a significant restriction to the growth, within a context of required stimulus to economy.

## **Asian underdeveloped countries**

- It is well known that a major exchange flexibility will not only contribute to the use of the monetary policy with anticyclical purposes, but also reduce the competitiveness of its exporting sector and might generate an instability in the trading and investment flows.

# Dilemmas for correcting the U.S.A. external unbalance

- The deepening and support of United States Current Account deficit: one of the main structural problems of the North American economy and significant risk for the world economic stability.
- The current external conditions and great influence of global investors' expectations do not discard the possibility that the correction of unbalances are abrupt if there is a change in the outer environment.
- The maintenance of the interdependence relation between the United States and the rest of the world, not only has avoid the crisis up to the moment but also takes the adjustment certainty implicitly.

# Dilemmas for correcting the U.S.A. external unbalance

- An adjustment of the exchange rate of the main currencies will not only contribute to the correction of this unbalance but also have adverse outcomes for North American and global economy.
- For underdeveloped countries, correction will imply serious affectations in relation to the value of the assets and liabilities in dollars, as well as the performance of its external sector, the current driving force of its growth.
- The policies currently proposed by the main international organizations in order to correct the external unbalances suppose a reinforcement of market mechanisms and significant conflicts of the economic policy.

## **Dilemmas for correcting the U.S.A. external unbalance**

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- **The U.S.A. faces important challenges in the management of its economic policy :**
  - A weaker dollar not only contributes to deficit adjustment but also implies that U.S.A. have less capacity to get the external financing also required to defray the growing budget deficit.
  - Ensuring the adjustment graduality contradicts the foreseen support of significant fiscal unbalances associated to the expansion of military expenses, established in their current geopolitical strategy.
  - The incompatibility between the unilateralism of its foreign policy and the international economic cooperation required to alleviate the global unbalances.