CURRENT ACCOUNT

Red Ink

April, says the poet, is the cruelest month. But to anyone concerned about the U.S. performance in world trade this year, the cruelest month is February. This is the month when the first estimates of America's balance-of-payments figures for the preceding year are released. And this month the figures for 1983 will show the biggest merchandise trade deficit in the country's history—close to $70 billion. Worse, projections for 1984 suggest a deficit approaching $90 billion. Compare this with a deficit of only $35 billion in 1982 and a sizable surplus as recently as 1975, and the diagnosis seems clear: The United States is hemorrhaging red ink in international trade on an unprecedented scale.

To be sure, the deficits in our merchandise trade balance are to some extent offset by surpluses in services—the so-called "invisible" items like transportation, tourism, and banking. America for many years has been the biggest exporter of services in the world. But even as our merchandise deficits have been trending upward, our invisible surpluses have declined. The two together, along with "unilateral transfers" of various kinds (foreign aid grants, worker remittances, etc.), are combined in the most popular measure of a country's performance in international trade—the current account. America's current account, which showed a $5 billion surplus as recently as 1981, slid to a deficit in excess of $30 billion in 1983. This year the deficit could top $50 billion.

Does this mean that the United States can no longer compete effectively in the world economy? Has American business lost its touch? Is the hemorrhage of red ink fatal?

The short answer is, No. American business is very much alive, as should be obvious to anyone familiar with the continued strength of our exports in such sectors as agriculture, capital goods, and transportation. Some industries, we know, are indeed no longer able to compete as effectively as they once did, including automobiles, consumer electronics, and basic steel. But that is all part of the dynamics of change in the world economy. Comparative advantage is always shifting from industry to industry and nation to nation; and while the consequent structural adjustments are often painful, they do not constitute a signal that the economy as a whole is moribund. Quite the contrary: Since the beginning of our recovery from recession over a year ago, the vital signs of the U.S. economy have been exceptionally strong. It is not time to write America's foreign trade obituary yet.

"You're passing on whose *increased costs?"*

So what *is* going on? In fact, our deteriorating trade performance has two principal explanations. First is the inflated value of the dollar, which has severely handicapped American business in its ability to maintain market shares abroad or compete with imports at home. Since 1980 the dollar has appreciated more than 30 per cent in relation to other major currencies, owing to massive inflows of capital attracted by our record high interest rates. That appreciation has meant a loss of price competitiveness in international trade despite lower domestic inflation, depressing sales abroad, and increasing purchases of foreign goods at home. It was as if we had imposed a 30 per cent tax on all exports and provided a 30 per cent subsidy on all imports. The resulting deterioration of our trade balance was a major factor in the recession of 1981-82, accounting for more than 40 per cent of the overall drop of GNP. There is no question that the dollar's overvaluation—recently estimated at some 18 per cent by John Williamson of the Institute for International Economics in Washington—delayed recovery substantially. And given the usual lags in the responsiveness of foreign trade to changes of exchange rates, there is also no question that the hemorrhage of red ink will continue for some time even *after* the dollar's overvaluation is corrected.

The second explanation lies in the recovery itself which, once started, naturally tended to pull in imports from abroad. A growing economy requires growing amounts of raw materials, energy, and capital goods; rising levels of personal income also mean more spending on consumer goods, foodstuffs, and foreign travel. Given the delay of recovery in most other industrial nations, and the absolute stagnation of most Third World economies, this development was by no means unwelcome. Increased sales in the United States functioned like Keynesian pump-priming on a global scale, stimulating recovery elsewhere as well. From the foreign point of view, our hemorrhage was more in the nature of a transfusion.

In time, of course, as recovery elsewhere begins to catch up with our own, U.S. sales in foreign economies will start to grow too. And sooner or later the dollar will drop as well, leading eventually to further improvement of our trade performance. The problem is to get through this period of unprecedented deficits without resorting to panic remedies of a protectionist nature: import duties, quotas, and the like. Such quack cures are worse than the disease. Red ink should not be mistaken for our life's blood.

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