

"SOLVING THE TRADE DEFICIT PROBLEM"

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People frequently ask me what I consider to be the most important economic problem facing the United States. At the present time, I can unhesitatingly answer that it is the international trade deficit and the adjustments required to correct that deficit, both here and abroad.

As you may know, the record U.S. trade deficit last year has led to a flurry of proposed legislative remedies. Congress is currently working on a trade bill intended to improve competitiveness of American products on world markets and to reduce unfair trade practices by some of our major trading partners. Although these goals are laudable for their own sake, achieving them would not solve our trade deficit problem. The only realistic way to reduce the U.S. trade deficit is to lower the government budget deficit.

A danger in the proposed legislative remedies is that they could degenerate into protectionism. Congress is beset by pleas from several industries for trade barriers to relieve competitive pressures from imports. Yielding to protectionist pressures threatens to unravel the international trading order that is essential for balanced growth in the world economy. Moreover, trade barriers are destructive to our domestic economy. They result in fewer jobs, not more. They also reduce U.S. living standards and lead to higher prices for American consumers and businesses.

Congress would better serve the American people--and make more progress in reducing the trade deficit--by focusing its energies on reducing the government budget deficit. Unfair trading practices by our trading partners aren't new; nor is the dismal growth of productivity in the U.S. economy. Therefore, it is reasonable to ask how these problems can account for the rapid turnaround in our trade

balance from a surplus in 1981 to a record deficit last year. They can't, in my view. The distinguishing features of the U.S. economy in recent years have been the large deficits in both the federal government's budget and in the U.S. trade position.

The relationship between these twin deficits is more than coincidental--and it is not clearly understood by some elected officials and the public. As the economy recovered from the last recession, increased credit demands by businesses and consumers were piled on top of heavy government credit demand to finance the massive budget deficit. Due to the low saving ^{rate} level of the private sector, these excessive credit demands forced the United States to borrow large amounts from abroad, forcing up U.S. interest rates and the exchange value of the dollar to levels that have made it difficult for U.S. firms to compete effectively in world markets. The sad fact is that the combined consumption by the private and public sectors has exceeded what we have produced. As a result, we have been forced to fill this gap by importing more goods and paying for them with funds borrowed from abroad. There is no doubt that the government budget deficit is the major cause of our current trade deficit.

Identifying the cause of the trade deficit should clearly identify the most effective solution. Yet progress in reducing the budget deficit has been discouragingly slow. Despite spending cuts and revenue increases, the federal government this year will spend about \$170 billion more than it takes in. It is essential, therefore, that the President and the Congress agree on a credible program to restore fiscal discipline. Lower budget deficits, together with the considerable decline in the value of the dollar that has occurred

already, will improve the ability of American firms to sell their products in both domestic and foreign markets.

But even the most optimistic assumptions about U.S. economic policy lead me to a guarded outlook for the trade deficit problem unless our actions are complemented by economic policy changes elsewhere. Our trade balance depends not only on policies in this country but also on decisions made in Frankfurt, Tokyo, London, and other capitals around the world. It will be very difficult for U.S. firms to regain market shares in foreign countries if those markets are not expanding. Our major trading partners need to take policy actions to ensure that their economies continue to grow without relying on the stimulus of exports to the United States. Europe and Japan must start importing more and exporting less.

The Federal Reserve's role is to ensure that the depreciation of the dollar does not cause a sharp acceleration of inflation. Developments in financial markets over the past few weeks suggest that the legacy of high inflation is unfortunately still with us. My colleagues and I on the Federal Open Market Committee are convinced that U.S. monetary policy has the responsibility for ensuring that the higher import prices necessary to reduce our trade deficit do not lead to a permanent reversal of our progress toward price stability.

Despite our best efforts, the U.S. economy will remain healthy only if Congress and the Administration can resolve the impasse over how to reduce budget deficits, while avoiding protectionism. If so, the 1990s can be a decade of prosperity--with balanced economic growth, low inflation, and a renewal of American competitiveness in world markets.