What can explain large current account deficits?: Discussion of the U.S. case study

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Jay C. Shambaugh
Georgetown University and NBER

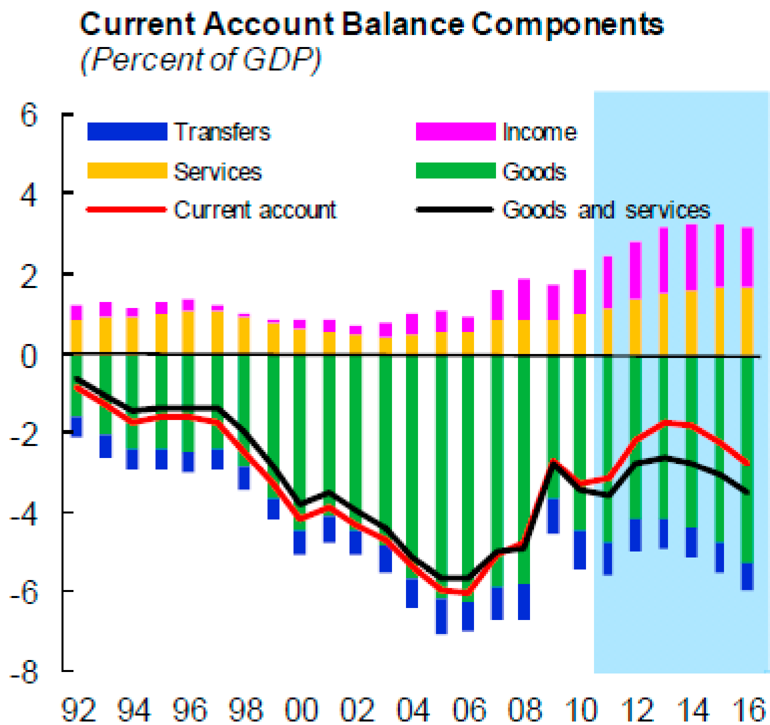
Summary

- Paper considers both CA and fiscal imbalances, has interesting points on both.

My comments:

- On CA: what do we want it to be? Why?
  - Need to have a clear understanding of what the problem is if we are going to advocate changes.
- On fiscal: again, what is the problem?
  - How far really does policy need to change?
  - Should IMF recommend specifics (entitlements, etc) & over what horizon.

What should the CA be?



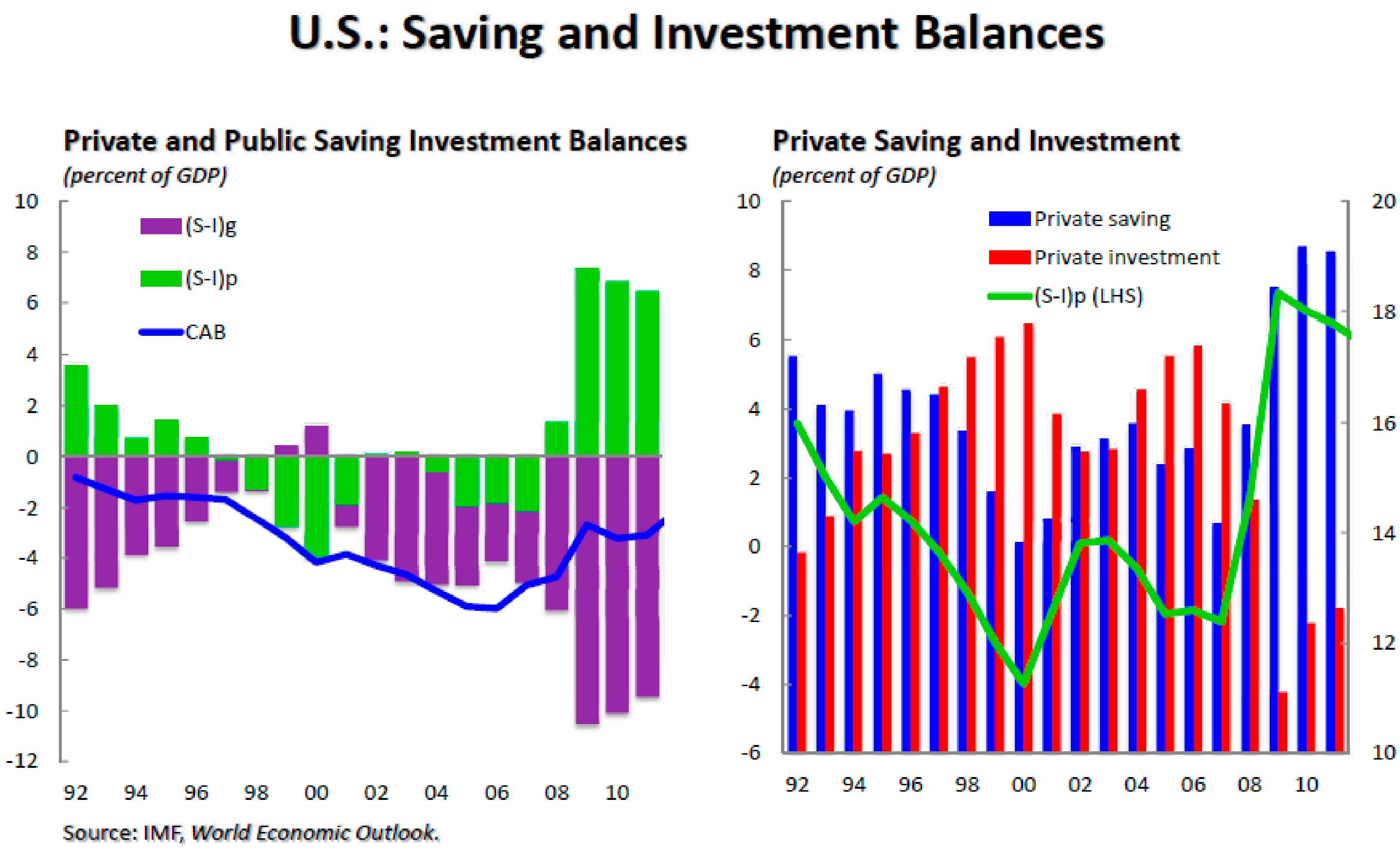
- 5 years ago, would we have been OK with a target of 3% of GDP?
  - 2009 fell below, 2010 a bit above, but by Q3 2011, below again.
- If not, Why Not?

Reasons to worry about a U.S. CA deficit

- **Symptom of other problems**:
  - CA may reveal excessive borrowing in the economy (often triggered by credit boom) see Obstfeld AEA lecture
- **Getting too far into external debt**
  - Even moderate CA deficit could build a large external net debt over time
- **Systemic issues**: a large country could be "using" too much of global savings
- If below full employment, you **may worry about a lack of demand** for a country's products
  - Especially a concern at zero lower bound

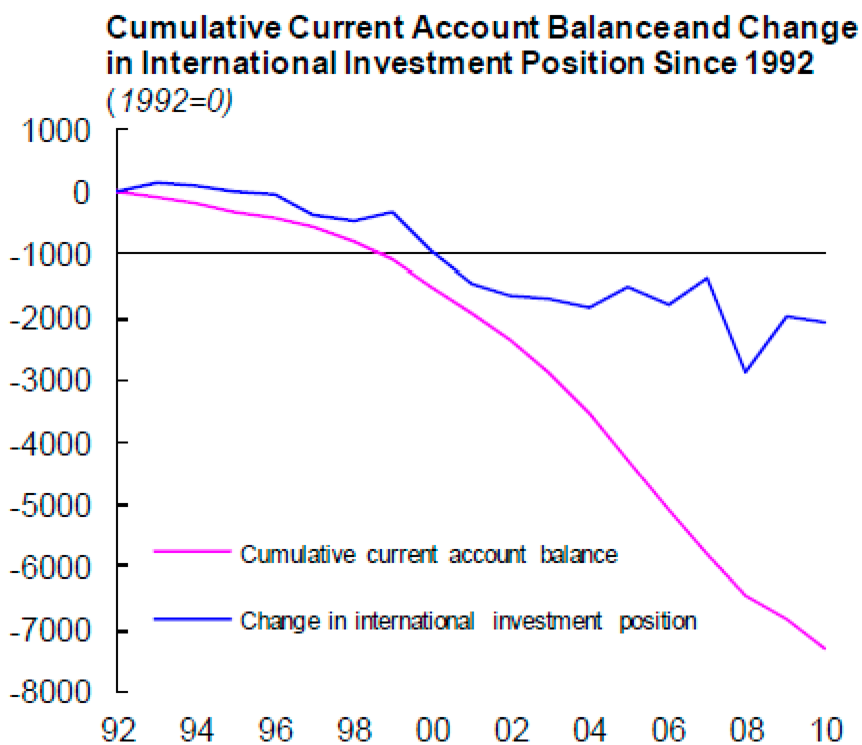
- Is a large reckoning needed?

Symptom? Not of private overborrowing/credit boom



- Certainly was in earlier periods, but now?

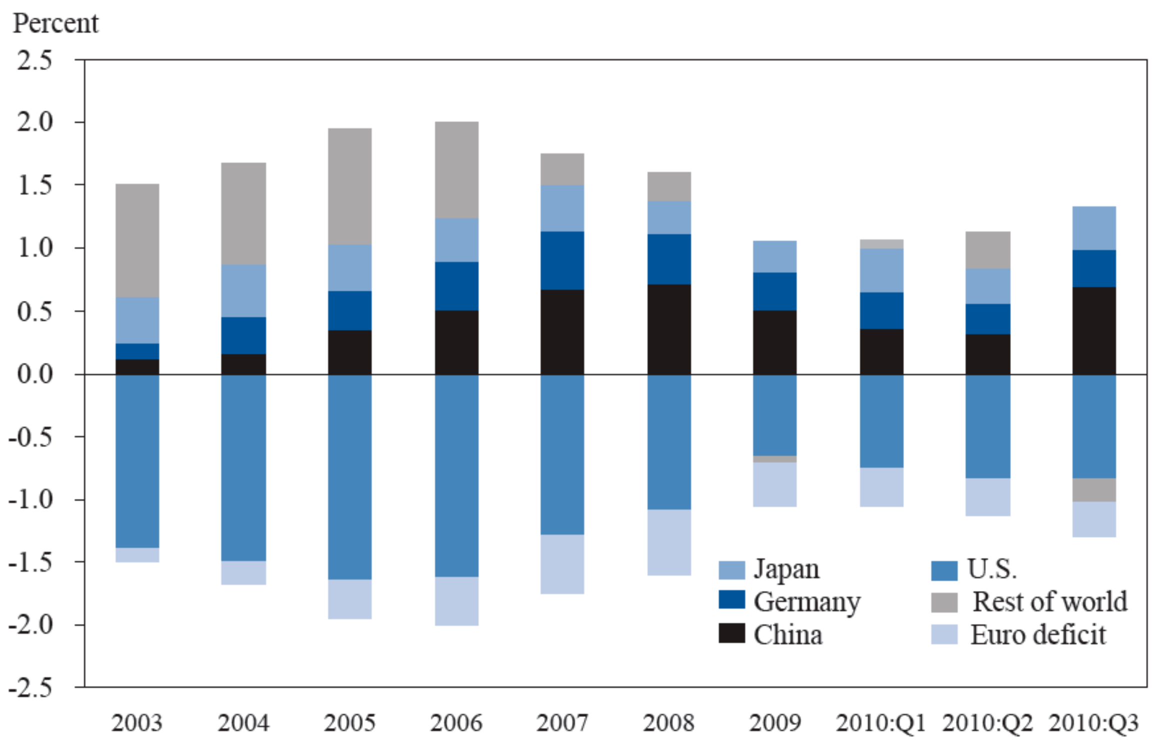
Getting too far in external debt? No.



- Fair to worry that this can't continue, but U.S. not a large debtor currently (and still net positive on income)
- Note: this is in report, not criticizing, highlighting.

Using too much global savings?

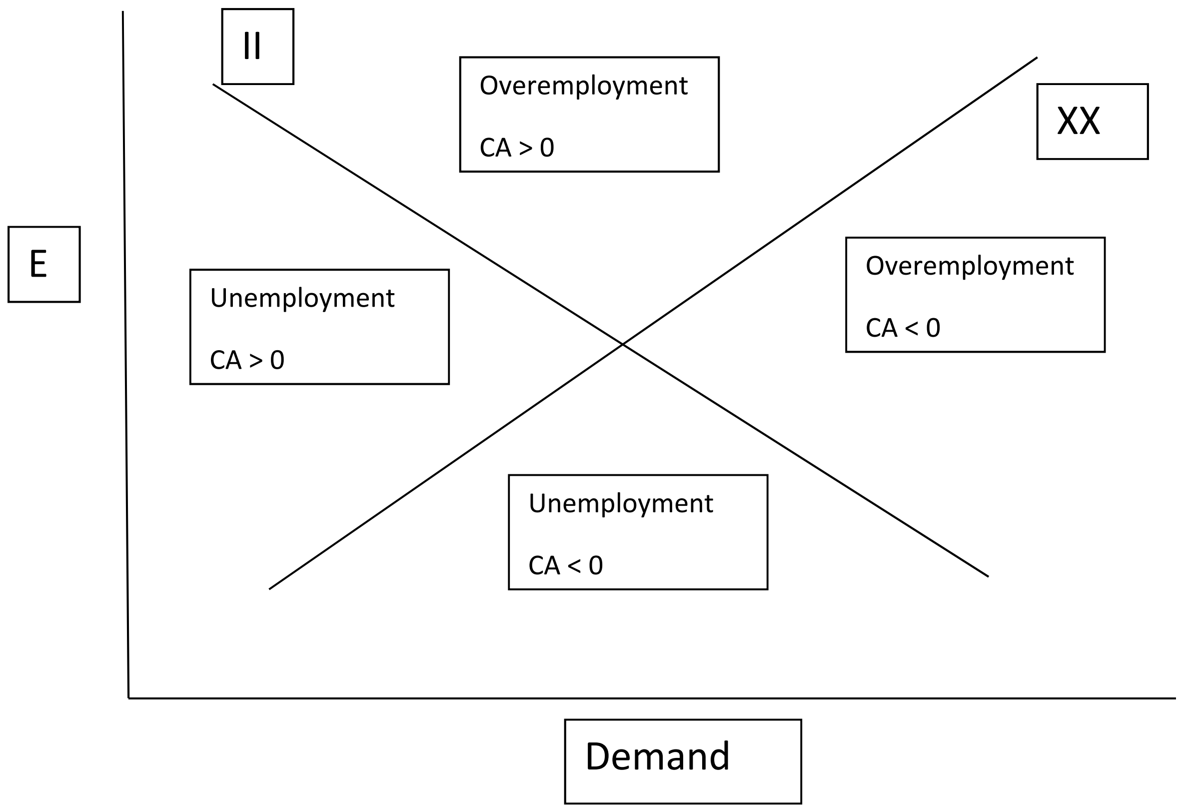
Current Account Deficits or Surpluses as a Share of World GDP



Notes: "Euro deficit" represents France, Greece, Ireland, Portugal and Spain. "Rest of world" represents all other countries not shown here plus the statistical discrepancy.
Sources: Country sources; CEA calculations.

- Certainly fair critique earlier, but now, it seems the major savers are saving too much.

Lack of Demand: Recall classic IIXX model



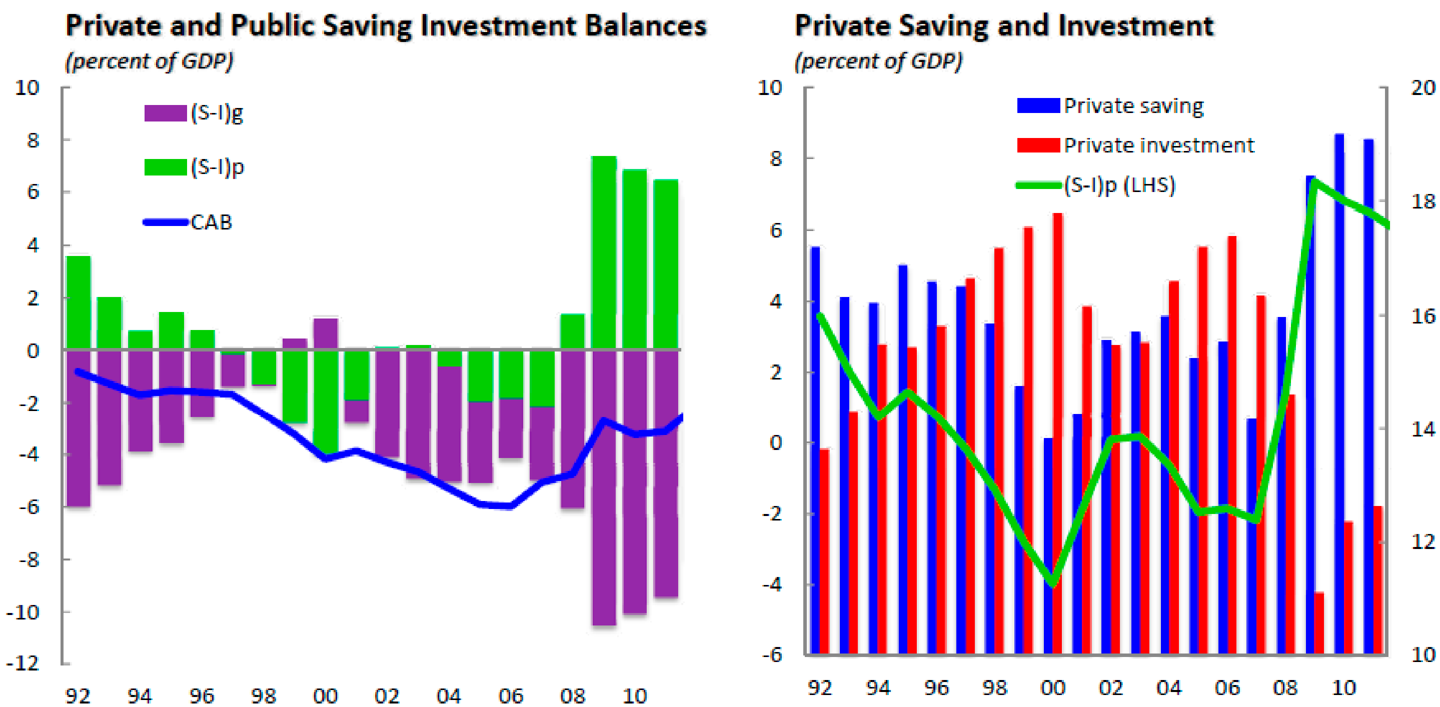
- What we do about a CA deficit should depend on where we are in this figure. Suggests emphasis on the relative prices angle.
- Need to distinguish current analysis from pre-crisis. Description of the rise of the CA deficit is totally distinct from where we are now.

So, should we be focused on U.S. fiscal? Arguably, not in this session.

- Hard to argue that fiscal is pushing demand above a sensible level and generating too much borrowing.
- Report also has a lot to say about medium term U.S. fiscal (a fair concern).

Budget balance and the CA

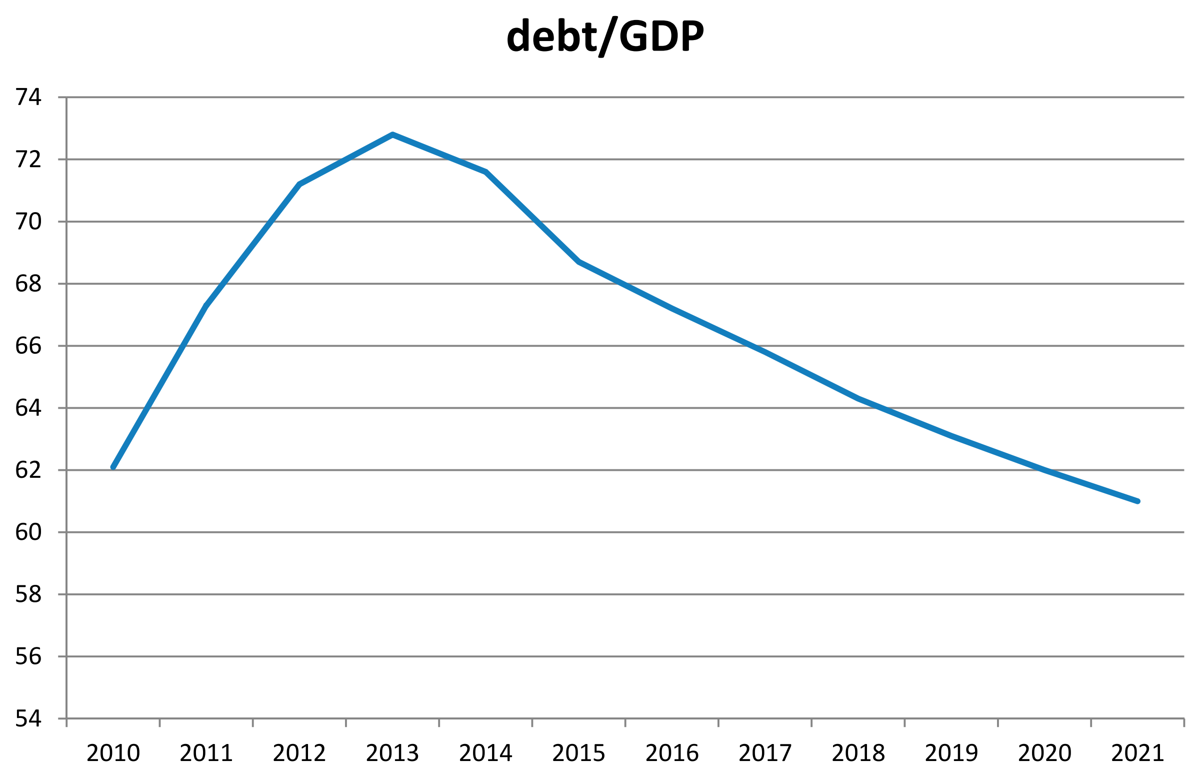
U.S.: Saving and Investment Balances



Source: IMF, *World Economic Outlook*.

- Budget deficit balancing deleveraging. Problem?
- Report is correct that Deficit must fade as investment picks up (or private saving falls)

What fiscal problem?
CBO baseline scenario

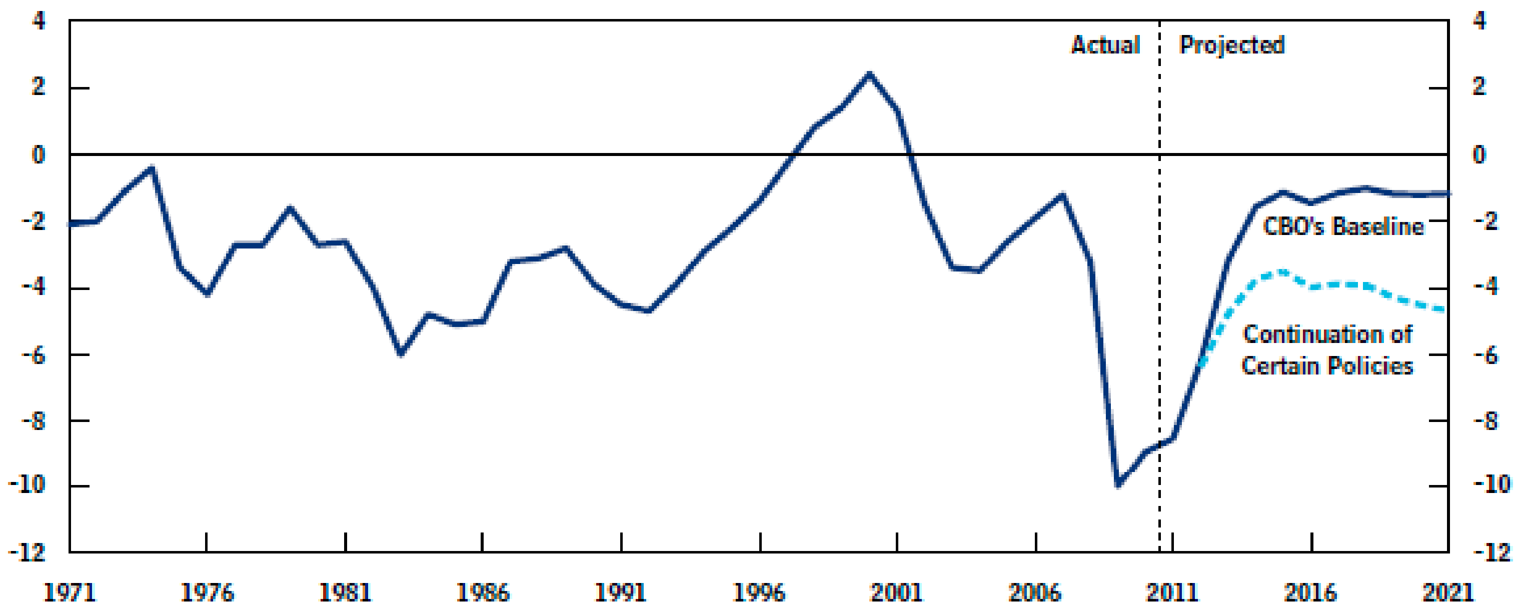


Current law fiscally restrained

Figure 1-1.

Total Deficits or Surpluses—Historically, in CBO's Baseline, and with a Continuation of Certain Policies

(Percentage of gross domestic product)

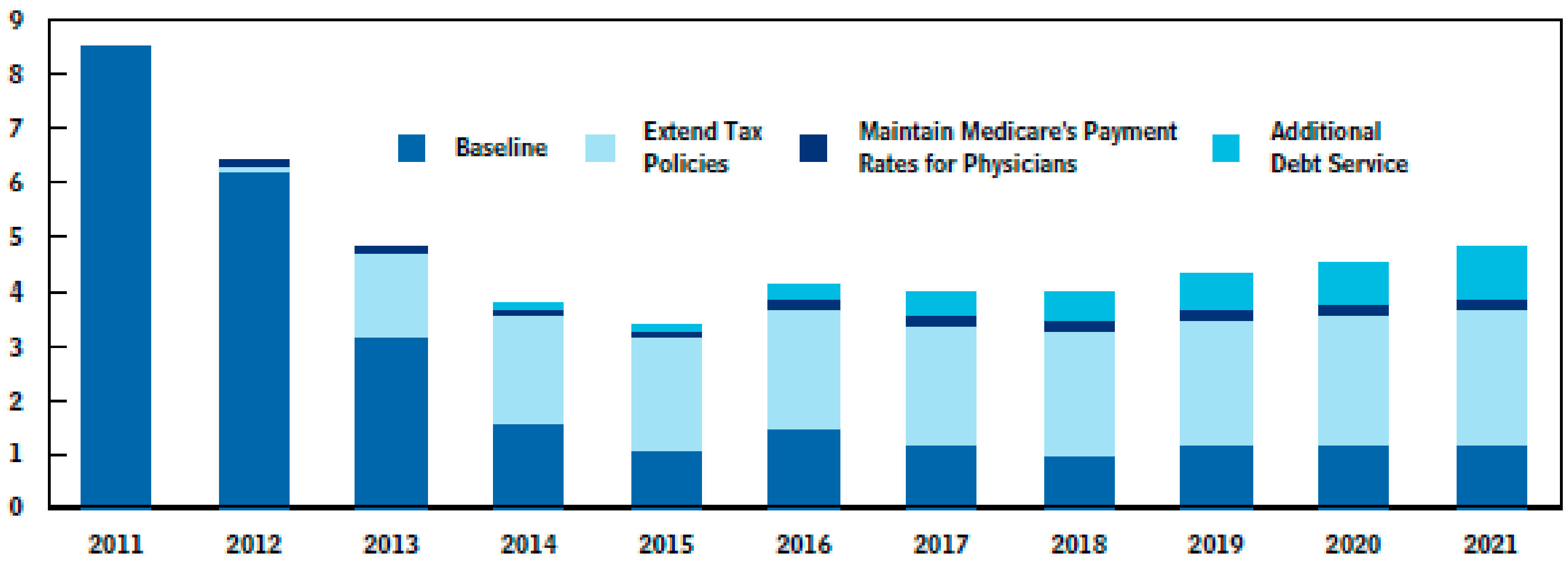


Where does the problem come from?

Summary Figure 1.

Deficits in CBO's Baseline and Assuming a Continuation of Certain Policies

(Percentage of gross domestic product)



Remember, current law matters when obstruction is the binding constraint

Even Current Policy (not law) is very close to what one would want

Table 3–4. THE STRUCTURAL BALANCE

(Fiscal years; in billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Unadjusted surplus (–) or deficit	160.7	458.6	1,412.7	1,293.5	1,645.1	1,101.2	767.5	644.6	606.7	648.7	626.7	618.9	681.5
Cyclical component	–94.3	–12.9	353.6	477.0	505.7	527.2	422.6	280.3	153.3	64.5	15.6	0.4	0.0
Structural surplus (–) or deficit	255.0	471.4	1,059.1	816.5	1,139.4	574.0	345.0	364.2	453.5	584.2	611.2	618.5	681.5
(Fiscal years; percent of Gross Domestic Product)													
Unadjusted surplus (–) or deficit	1.2%	3.2%	10.0%	8.9%	10.9%	7.0%	4.6%	3.6%	3.2%	3.3%	3.0%	2.9%	3.0%
Cyclical component	–0.7%	–0.1%	2.5%	3.3%	3.4%	3.3%	2.5%	1.6%	0.8%	0.3%	0.1%	0.0%	0.0%
Structural surplus (–) or deficit	1.8%	3.3%	7.5%	5.6%	7.6%	3.6%	2.1%	2.0%	2.4%	3.0%	2.9%	2.9%	3.0%

NOTE: The NAIRU is assumed to be 5.3%.

As cyclical component of deficit fades, Administration gets roughly 3% of GDP deficit – not enough to bring down debt levels, but sustainable.

Assumes no substantial permanent loss from crisis (but in the distant out years, forecasts should converge, so differences would affect debt not deficit).

Thoughts on U.S. fiscal

- Seems emphasis should be on going slow and notion that fiscal is not the problem with imbalances right now.
- Seems emphasis should be that current law and policy are fine, and the key is that the U.S. must not make mistakes.
  - Notion of "crowding out", instability in debt markets, and any reference to S&P is a mistake.
  - Almost feels like report is stretching to say why we should worry
- Notion that the U.S. must cut entitlements seems overstepping.
  - Low revenue. Political choice whether to raise revenue or reduce entitlements (retirement age rising and already fairly high).
  - ACA actually the key policy move. Problem is not "entitlements" it is health care costs.

Conclusion

- Informative report with a lot of useful information.
  - Many of my figures just straight from report, not a critique, but a shift in emphasis.
- Need to avoid policy analysis hysteresis.
  - Same symptom can have different causes. Need to adjust discussions even more substantially (report does a good job but could go farther).
  - IMF has gone further than any organization in preaching a need for measured pace of fiscal consolidation, I would reflect those views here.