Boma10 John Hyde

The Reagan administration might be kidding, but in public it blames its own trade deficit on an undervalued German Mark and Japanese Yen, lack of economic growth in the rest of the world, and lack of international co-operation generally. The American public and Congressmen are blaming so-called unfair Japanese trade practices. And they seem to fear that American work practices and capital structures are deficient relative to those of foreigners. Both the public and the administration seem to believe that the trade imbalance could continue indefinitely. Neither wants to accept that the problem might be home-grown.

According to Professor Martin Feldstein, Professor of Economics at Harvard University and President of The National Bureau of Economic Research, both are wrong. The trade deficits were caused by the 70% rise in the value of the US dollar between 1980 and 1985 and now that the currency is falling the defícts will be reversed automatically.

The dollar rose because of high real interest rates. These in turn were caused by the need to squeeze inflation and fund very high budget deficits. This combination of tight money (a short supply of dollars) and fiscal laxity (a high demand for dollars) drove up interest rates. Higher real interest rates than were available in other currencies created a demand for US dollar denominated investments. This drove the value of the dollar up in terms of other currencies as foreigners tried to buy dollars to make the investments. The high currency made United States producers of traded goods less competitive and the trade deficit (the exchange of US dollars for foreign goods) was the inevitable balancing item---the means by which the non-US investors acquired the dollars they wanted.

Like their Australian counterparts, United States trade deficits have domestic causes. There are differences however. The most obvious is that American inflation is much lower than ours. Another is that the American economy is much less sclerotic than the Australian. In particular, it is blessed with a relatively flexible labour market to facilitate the necessary adjustments.

Although the US trade deficit, a high 3% of the US gross domestic product, is not much lower than ours, it is a recent phenomenon. Until 1981 the US ran current account surpluses with which it financed investments in other countries and the United States has only recently become a net debtor. By contrast, Australians already owe $100 billion, which is equivalent to some 40% of their GDP, to foreigners. When an American talks of his country's foreign debt problem he is almost certainly talking of shaky debts owed *to* Americans rather than by them.

Another difference is that, while what the US does affects all the world, not many non-Australians would notice if we sank or swam. Our foolishness has the capacity to injure only ourselves, whereas if the US congress were to, say, attempt to correct their trade imbalance by raising trade barriers they would in all probability trigger a worldwide depression. The Smoot-Hawley act, which excluded a wide range of imports, especially textiles, from the United States, is universally blamed for deepening the Great Depression.

While I dare say that jawboning has a small place in international economics, Feldstein does not think that summit meetings, such as the G5 meeting when the leaders of The United States, Japan, Germany, Great Britain and France discussed each other's economic policies, can change anything fundamental. Neither do I expect Americans to be impressed by the pleas of Australian farmers and politicians. If trade is to flourish again, Americans and citizens of the European Community have to be convinced that it is not in their own interests to pay through the nose for inefficiently produced domestic meat and grains. Australians must be similarly convinced that they are unwise to pay through the nose for textiles and motor cars.

One cannot help suspecting that the widely publicised excursions to the US by Australian politicians are largely for Australian domestic consumption. The suspicion is reinforced by the inadequate priority given to improving the appallingly bad Australian transport and handling systems or reducing Australian trade barriers.

Although the US has become a debtor nation only recently, Professor Feldstein is concerned about 'ever growing debt service costs.' 'Such an exploding level of debt is unsustainable', he says. I wonder what he would have to say about Australia, which has bigger debts and much less capacity to change course?

Feldstein writes, 'I expect that by the early 1990s the United States will again be running a merchandise trade surplus.' This probability has implications for Australian producers of those traded goods which are in most direct competition with US producers.

The counterpart to the US trade deficit is the surpluses of most of the United State's trading partners. Their currencies are rising relative to US dollars and, as the US deficit is reversed, their trading partners' exports will necessarily shrink and their imports grow in response to lower prices for both. Higher imports and lower exports will allow them to enjoy (even) higher living standards or allow them to put more to domestic, as opposed to foreign, investment. We must expect the best trade opportunities in the 1990s to be found among these nations.

Because of accumulated foreign debt Australia does not have the same easy option as the United States of an automatic massive devaluation automatically setting to rights our foreign account deficit. While devaluation has indeed improved the competitive position of our exporting and import-competing industries it has also increased the cost of servicing our debt. Further, the Australian habit of indexing costs, especially wages, and protecting everything that moves from price competition effectively denies Australia the opportunity to make the necessary internal adjustments. Unless we produce more or consume less we cannot export more and import less. We will need to produce a great deal more---more than is conceivable---if we are not to experience falling consumption---that is, falling living standards.

As America shifts to trade surplus we can expect the clamour in that country for protection to die away. It may rear its ugly head in the new trade deficit nations, however. As these, in economic terms, dramatic changes occur, Australia, a defict nation with too much foreign debt and high inflation, will have to do the best it can from a position of weakness.

The best thing our government can do is get out of the way of entrepreneurs who try to take advantage of such windows of opportunity as open. We cannot know where the best chances will be but we do know from past experience that they will often be in unexpected places. They will include new products, new technologies producing old products and unheard of markets. We also know that some will be for products and services for domestic use and some for export---one is not inherently more valuable than the other. What matters is that the product or service is the best value that money can buy. A big window may open, but the windows of opportunity are likely to be many and small.

We know that civil servants, however competent, can have neither the knowledge nor the incentive to spot and use them, but that together, tens of thousands of entrepreneurs might; if only a taxing, regulating government does not get in their way.