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LADB Staff

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Federal Reserve Chairman: Protectionism No Answer To U.S. Trade Deficit

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At a Sept. 24 hearing in the House Subcommittee on Trade, Federal Reserve Chairman Paul Volcker argued that the federal deficit must be reduced; trade surplus nations must stimulate domestic demand, thereby importing more goods; developing nations must improve their economic efficiency and stability, and commercial banks and multilateral lending agencies must support the reform efforts of debtor countries.

According to Volcker the most striking "reflection" of strains in the world economy is the enormous U.S. trade deficit, and counterpart surpluses of some other nations. In the second quarter of 1986, he pointed out, the US trade deficit approached $150 billion. The U.S. deficit, he added, is related to more fundamental factors relative rates of economic growth, the size of the US budget deficit, exchange rates, and the international debt crisis.

Volcker stated that since 1980, the value of US non-oil imports has nearly doubled. Total imports are running at some $360 billion, despite large declines in the oil import bill. Next, the total value of US exports was about $220 billion per year, or only 60% of imports. The trade surplus the US has tradtionally run on services and other current account items has virtually disappeared, the Fed chairman pointed out, reflecting primarily the growing amounts of interest paid on the nation's increasingly heavy overseas indebtedness.

While borrowing abroad, he said, is a ncessary counterpart of a current account deficit, the US has been dependent on foreign borrowing in another sense as well: it has had the practical effect of largely offsetting the huge demands on US money and capital markets from the budget deficit. This process, according to Volcker, is not indefinitely sustainable. Next, Volcker emphasized that the US is now by far the world's largest debtor country, and even under favorable circumstances, net indebtedness will increase substantially in coming years.

Of course, he said, US external debt relative to GNP is still rather minor, but the trend is disturbing. In an effort to persuade congresspersons that protectionism is not a satisfactory response to current difficulties, Volcker said, "We preach to Latin America and others the need to find solutions to their problems in the context of an open trading system, and in the efficiencies and productivity that fosters. But of course that won't work unless our market and others' are open to them. And the lesson of the benefits of a liberal trading order is equally applicable to all of us."

According to Volcker, as a group, the 15 heavily indebted nations more or less arbitrarily associated with the so-called Baker Plan were in rough current account balance in 1984 and 1985. In 1981 and 1982, in contrast, they had an aggregate deficit of about $50 billion. In other words, the collective trade surpluses of those countries rose to the point they offset interest payments on outstanding

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debt, and interest payments continue to move downwards. He said there were signs of progress in the developing world, stating that a number of heavily indebted nations are now growing again.

The world's largest single debtor nation, Brazil, was used as an example. Next, Volcker emphasized progress in the sense of a more favorable attitude in developing nations toward private investment, both by citizens and foreigners, and moves to improve the efficiency and competitiveness of export industries. However, he said, that progress is not uniform or firmly ingrained in economic or political structures. It is much different from the past, or efforts toward achieving self-sufficiency and strong state control of industry.

Ultimately, this "process" will provide the basis for renewed prosperity, higher living standards, and greater political stability, he said. Volcker also indicated that the danger of overexposure to US banks has been considerably reduced. Since 1981, he said, there has been a striking decline in the exposure of American banks to the heavily indebted countries of Latin America relative to their capital. "That ratio for all significant lending banks fell from about 120% of bank capital to less than 75% at the end of March 1986, a 40% decline. Those exposures are actually considerably less than in 1977 when the data were first collected."

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