

II. Question: The Sustainability of the United States' Current Account Deficit: Is a Drastic Exchange Rate Adjustment Unavoidable?

**“Pro” Viewpoint: The United States’ current account deficit is not sustainable, and a drastic exchange rate adjustment is unavoidable.**

**Reason:** *Amounts of international capital of sufficient size to finance the United States’ huge current account deficit will cease to flow into this country.*

- a) Flows of private capital from Europe into the United States are decreasing, and official interventions in East Asia (by governments that purchase short-term U.S. treasury bonds) cannot be expected to cover the resulting shortfall. This is because the U.S. external deficit appears unsustainable when any of the following three factors in the American economy are taken into consideration: savings and investment balances, net exports, and foreign capital flows (cointegration analysis). In addition, a significant currency exchange adjustment (involving depreciation of the dollar and appreciation of other national currencies) is unavoidable given that the U.S. external deficit will, at some point, fuel inflation and prompt interest rate hikes in East Asian countries. [Ogawa, Brook]
- b) To reduce the U.S. current account deficit by approximately 1 percent of GDP, the dollar would need to depreciate by roughly 10 percent. [Brook, Obstfeld & Rogoff]

**“Con” Viewpoint: The United States’ current account deficit is sustainable, and a drastic exchange rate adjustment is avoidable.**

**Reason 1:** *The U.S economy is strong, and countries in Asia with fixed exchange rate regimes will continue to concentrate on exporting.*

- a) The underlying strength of capital flows that come as the result of high-return investment opportunities, supported by the fundamental strengths and high rates of productivity found in America’s “New Economy,” should not be underestimated. [Keidel, Hisatake]

- b) Savings rates in other countries are high in comparison to those in the United States. However, economic stagnation in advanced economies and desires for stable exchange rates in strongly export-oriented countries in Asia stimulate outward flows of surplus savings. The United States is under pressure to absorb most of this savings on its own (and if it does not, the global economy will stall). Policymakers in East Asian countries are more concerned about growth in their national economies than they are about capital losses that might result from low-return investments in U.S. treasury bonds or depreciations of the dollar. Because of this, countries in East Asia are maintaining the status quo as far as the pegging of their currencies to the dollar is concerned (by purchasing U.S. treasury bonds). [Garber]

**Reason 2: *The sustainability of fiscal deficits viewed in a positive light.***

- a) The U.S. fiscal deficit is sustainable for at least the next several years, and is the result of unusual circumstances such as the war in Iraq. Of course, it would be desirable to reduce this deficit, and doing so would help eliminate macro-level imbalances and reduce the current account deficit as well. Correcting the U.S. fiscal deficit is thus a task of the highest priority, and something that this country is capable of doing on its own. [Keidel, Ito]

**Remaining Issues:**

- 1) The size of a sustainable U.S. current account deficit is not necessarily zero. What factors determine the size of such a sustainable deficit (or stated differently, the size of a “natural deficit”)? Is it the aggregate savings of countries outside the United States? Similarly, what role might “home bias” play?
- 2) When will the U.S. current account deficit become difficult to maintain? Analyses should be performed of factors determining the inward flows of private capital that in turn influence the sustainability of this deficit.

(Editors: Hiroya Tanikawa and Masaru Yoshitomi)