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Richard N. Cooper is Maurits C. Boas Professor of International Economics at Harvard University, where he has been since 1981. He has written extensively on questions of international economic policy, including The Economics of Interdependence (1968), Economic Policy in an Interdependent World (1986), The International Monetary System (1987), Can Nations Agree? (with others, 1989), Economic Stabilization and Debt in Developing Countries (1992), Boom, crisis, and Adjustment: Macroeconomic Management in Developing Countries (with others, 1993), Macroeconomic Policy and Adjustment in Korea, 1970-1990 (with others, 1994), and Environment and Resource Policies for the World Economy (1994), **as** well as over three hundred articles.

In 1990-92 he was chairman of the Federal Reserve Bank of Boston. From 1963-77 he was professor of economics and Provost (1972-74) of Yale University. He has served on several occasions in the U.S. government, as Chairman of the National Intelligence Council (1995-97), Under-Secretary of State for Economic Affairs (1977-1981), Deputy Assistant Secretary of State for International Monetary Affairs (1965-66), and senior staff economist at the Council of Economic Advisers (1961-63).

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Is America's Trade Deficit Sustainable?

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The current account deficit of the United States -- all imports of goods and services, less America's exports -- will exceed $300 billion for 1999, nearly 3 percent of GDP on a national accounts basis, and will probably exceed $300 billion in the year 2000 as well. It has of course been enlarged by the economic slowdown in East Asia, including Japan; their imports have stalled, while they export aggressively in order to restore growth. More vigorous growth in the rest of the world, now generally forecast for next year, will stimulate American exports.

Foreigners do not give their goods to Americans. Indeed, the US current account is as high as it is, and growing, because foreigners want to invest in America -- in stocks, bonds, real estate, industrial plant, and other assets. Investments in America are viewed favorably around the world, and for good reason: the US economy is a good, steady performer, less sluggish than Europe and Japan, less volatile than emerging markets. Inflows of investment funds push up the dollar and make foreign goods more competitive.

Like all investments, some will go bad and foreigners will lose their money, as some did on real estate purchased in the 1980s. But on balance the claims will generate future income, especially for aging Japanese and Europeans. When they withdraw their accumulated savings, US exports will be stimulated by a weaker dollar. Until than, American obligations to the rest of the world will grow.

Investment by foreigners in the United States is good for them. It is also good for Americans, so long as we use their funds well, that is, invest in improved productive capacity and innovation in the US economy. If the investments yield 10-15 percent, and US obligations to foreigners yield 5-10 percent, as many of them do, all will benefit.

In the meantime, however, some American businesses will find themselves under severe competitive pressure from foreign goods, not fully offset by foreign demand for US exports. That could result in political pressures for increased 'protection, particularly as we move into a presidential election year. Americans should realize their advantage in producing attractive paper claims to future income, and continue to be willing to share those claims with the rest of the world.

How sustainable is the US deficit? Put another way, how long are foreigners likely to be willing to invest $300 billion a year in the United States, net of US investments abroad? Gross world savings outside the United States will exceed $5 trillion in 2000. $300 billion will be less than six percent of this magnitude. It is not beyond imagination that foreigners will want to invest six percent of their savings in the United States, which in 1998 accounted for over one quarter of gross world product and whose stock market capitalization was nearly half the world's total. (The figure would have to be a few percentage points higher -than six percent to allow for continued net investment by Americans in the rest of the world, but still falls comfortably within the range of plausibility.) To repeat, investments in the United States have provided, and are likely to continued to provide, returns that are both high and reliable compared with most other parts of the world, where they are reliable but low, or sometimes high but unreliable.

Suppose this prospect turns out not to be realized, i.e., suppose foreigners collectively decide to invest less in the United States than is required to finance a current account deficit on the order of $300 billion plus $100-200 billion to aliow for net investment abroad by Americans. What would be the consequence? The dollar would depreciate, making foreign goods more expensive to Americans and making US products more competitive in world markets. In time, the US current account deficit would decline to match the net foreign investment in the United States. Given the lags, and the fragility of expectations in financial and especially in foreign exchange markets, it is possible, indeed likely, that the dollar will tend to depreciate farther than is necessary to correct the underlying imbalance, and cries of alarm will appear in the financial press and in other quarters. But the excessive depreciation of the dollar is likely to alarm foreign exporters, and their governments, more than Americans. In the end, foreign central banks are likely to intervene in foreign exchange markets to break a large fall in the dollar, in effect supplementing foreign private investment in the United States with foreign official investment. That is the process whereby official foreign exchange reserves in the world rose to their current magnitude of over $1.2 trillion, around two-thirds held in US dollars, even though exchange rates among major currencies have been floating for more than 25 years.