Professor Blecker.

MR. BLECKER: Thank you, Mr. Vice Chairman, Dr. Weidenbaum, and members of the Commission for the opportunity to present my views here today.

Since the hour is late and of course there are many areas where all of us agree at some level, I will try to focus my five minutes of remarks on the areas of disagreement, but that’s not to deny that there are many areas of overlap in our analyses.

I will divide the causes of the trade deficit into two parts: first, the causes of the long-term decline in the U.S. trade balance, and, secondly, the cause of the recent surge in the trade deficit in the last few years.

Regarding the long run, I think the worsening trend exhibited in figure 1 in my written statement is due to structural imbalances in our trading relationships with other countries, including the persistence of de facto trade barriers abroad, differences in domestic institutions, policies, and practices, and a loss of competitiveness of U.S. producers vis a vis other countries.

Contrary to what some speakers have said earlier today, I believe that these factors operate in the long run as well as the short run, and I'd be happy to discuss that in more detail later. I would also point out that one can hardly attribute the whole trade deficit to good cyclical performance when, as figure 1 shows, the trade deficit is much worse today compared with 40 years ago. It's not just a matter of cyclical ups and downs. Of course, those exist, but there is also a long-term declining trend which I think has to be accounted for by any explanation.

This declining trend puts the United States in an uncomfortable policy position, because it forces us to choose. If we want to avoid rising trade deficits and growing international debt, which of course are of concern to Wall Street (and legitimately so) we have two choices. We can either depreciate the dollar in the long-term, which cuts the purchasing power of our currency, or slow our own income growth. And if we don't want to make those adjustments, which of course are painful and not desirable, then we have what we see, which is growing trade deficits and rising international debts.

As for the short run, I agree with what just about everyone has said here today. We can put different interpretations on it, but there are two key factors that explain the short-term rise in the trade deficit in the last few years:

number one, the rise in the dollar, which is also exhibited in my figures, and, number two, the slowdown in growth and recessions in almost all of our major trading partners.

Now, let me talk a little bit about the saving-investment identity, about which I think there's a tremendous amount of confusion, and which I think is frequently misused. Certainly, it's an identity that has to be respected. It's also an equilibrium condition in any international (open economy) macro model. But it is not a causal statement of what determines the trade balance.

While the trade balance, the saving- investment gap, net foreign investment, and the income-expenditure gap all have to be equal to each other, there are many possible explanations of why they could go up or down together. Some of those explanations would start with a story about low saving or a budget deficit, but some of them would start with a rise or fall in domestic investment, with an opening or closing of a foreign market, with a change in the competitiveness of American producers, or with a capital inflow attracted by conditions in financial markets.

All of these things can cause a change in these balances, which all have to equal each other. It is absolutely not true that the causality always has to start with the saving rate and everything else always has to adjust to that. It can work in other ways, and the saving rate, itself, can adjust to changes in other variables or underlying common factors.

Furthermore, I think it is quite misleading to claim that the net capital inflows of the last few years have financed a gigantic investment boom. This is based largely on what I think is an inappropriate use of constant dollar, or what they now call chained dollar, investment series. Those are useful for finding out the volume of investment -- how many capital goods you get for your expenditures.

But when we compare investment expenditures with savings, since the savings are always measured in current dollars, I think we must use a current dollar measure of the investment rate, and by that measure, as shown in my table 2, the investment rate (i.e., investment as a share of GDP) is not at all unusually high today for this point in a business cycle; that is, a period of prolonged expansion.

And what the net capital inflows have been financing, in my judgment, is primarily the unusually high consumption rate. If you'll look at the data, you'll see that the consumption-to-GDP ratio is at an all-time high, at least for the last four decades which I've looked at, and it's not just cyclical. There's a structural rise in that ratio, and I think that the capital flows are going largely to finance the consumer boom -- and the low personal saving rate, which is the other side of that coin.

In my written statement, I also give some projections of what will happen to the U.S. international debt position and our net interest outflows over the next several years, if the trade deficit stays on its current trajectory. I agree absolutely with what Dr. Mann said this morning, namely that while of course we're sustaining the trade imbalance now -- obviously we're borrowing and covering it today -- I believe that it is not sustainable in the long run if we stay on the trajectory that we are currently on.

As a result, I think there is an inevitable downward correction of the dollar that is coming, and the question is not whether it will happen, but rather when it will happen, how big it will be, and what will be the consequences for the real economy.

And here I'd like to signal a point of agreement with Dr. Makin, when he said that we should let the dollar fall. I agree very much that what would really turn the dollar's inevitable correction into a hard landing for the real economy would be an overreaction by policymakers who would excessively raise interest rates in a misguided effort to save the dollar.

When this adjustment comes, we are going to face some unpleasant choices, and I would rather avoid the hard landing for the real economy, and to a certain extent I think that means we have to let the dollar go.

My only caveat to that is that I think we should try to set a floor under how far the dollar should fall and try to convince markets, as we did in the late 1980's, that we have some target ranges for the dollar indicating where we'd like it to stabilize and which would be more consistent with balanced trade with our trading partners.

Finally, let me say that if we can convince our trading partners to expand their domestic economies and open their markets to more of our exports, we will reduce the amount by which the dollar needs to fall and reduce the sacrifices that American citizens are going to have to make in order to bring the trade deficit down in the long run.

Thank you very much.

VICE CHAIRMAN PAPADIMITRIOU: Thank you very much, Professor Blecker.