The speed at which faster money growth translates into higher inflation depends on expectations and on the amount of slack in the economy. When inflation expectations are widespread or when little capacity is available to accommodate foreign demand through increased output, faster money growth translates quickly into higher prices. Under such conditions, faster money growth might not result in even a transitory improvement in the trade balance.

Similar comments apply to the policy of encouraging growth in Japan and Germany. Such policies seek to increase demand for U.S. goods and services. If the United States is operating below full capacity, U.S. manufacturers can satisfy the increased demand through additional production. If the economy is operating at full capacity, however, prices in the United States will rise to choke off the increase in demand. The trade balance will not improve.

**Conclusion**

Any near-term success from promoting a dollar depreciation and encouraging faster growth abroad will owe much to the fact that the U.S. economy is not operating at full capacity. With unused resources, the increased demand for U.S. goods can generate increased production, employment, and real income. The higher income could generate savings and could help reduce the government budget deficit.

Economists, unfortunately, are not adept at measuring capacity or at predicting when capacity constraints will become binding. Although we do not expect that the United States soon will experience capacity constraints, the unemployment rate is reaching levels that many economists associate with "full" or noninflationary employment, and many economic forecasts now expect inflation to accelerate, although modestly.

Once the U.S. economy reaches full capacity, resources will be unavailable to satisfy foreign demand, and domestic prices will rise. Inflation-induced increases in income are not likely to generate additional employment, to encourage savings, or to help lower the total government budget deficit. Consequently, as the U.S. economy reaches full capacity, policies of promoting a dollar depreciation and of encouraging faster growth abroad will not be sufficient to lower the current-account deficit. The United States will need other measures to encourage private savings and to lower the government budget deficit.

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**ECONOMIC COMMENTARY**

**Requirements for Eliminating the Trade Deficit**
by Owen F. Humpage

If the United States is to eliminate its external deficit, it must satisfy basic economic conditions with respect to its private savings, private investment, and total government budget deficit. The U.S. current-account deficit reached a record $140.6 billion in 1986 and probably will not improve, on balance, this year. A slight worsening early in 1987 could offset a modest improvement late in the year. Consequently, the United States will continue to amass external debts and will become one of the world's largest debtor countries.

Economists, unfortunately, are not well-versed in the arithmetic of international transactions, plus some other adjustments that typically are small in magnitude.

Table 1 presents similar data for the United States since 1980. To facilitate comparisons over time, the data are expressed as percentages of GNP. The table shows that the increase in the U.S. current-account deficit since 1980 has been associated with an increase in the total government budget deficit and, since 1982, with a narrowing in private savings relative to private investment. The growth in the total government budget deficit reflects the huge federal
As previously explained, our current-account deficit reflects a decision to consume, both privately and publicly, and to invest more than we currently are producing. The purpose of table 1 is not to specify a channel of causation, but simply to show a tautological relationship among private savings, private investment, the government budget deficit, and the current-account balance. Nevertheless, the important implication is that steps taken to correct the current-account deficit will change private savings, private investment, the government budget deficit, and the current-account balance. Under these assumptions, even if the government deficit fails to affect both sides of the relationship permanently, it will not alter the current-account deficit.

Financing the Current-Account Deficit

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