“Habits and Policies and Global Imbalances: *For Whom Will Adjustment Be the Most Difficult?”*
Comments on “The Blind Men and the Elephant” by Barry Eichengreen

Professor Eichengreen surveys and debunks four views of the current account: The deficient US savings view—but fiscal and current account covariance is low and interest rates are low not high; the new economy view, but productivity trends between the US and Europe he sees as not all that different; the global savings glut view, but he argues that most regions are not saving more and the savings profile in Asia will not persist because of demographics; the Sino-US co-dependent view, which he discusses at length.

In my comments, I draw on my research on the co-dependency view. I argue that US and foreign habits are co-dependent: Foreigners’ habit is to save, export, and therefore to buy US treasuries and other US assets. The US’s habit is to consume, import, and therefore to sell assets (including US treasuries). At least at times, policy choices have exacerbated these habits, which leads to vulnerabilities, including financial exposure, misallocation of resources, and an increasingly costly adjustment path to sustainable internal and external balance.

With respect to policy choices that exacerbate habits, I note several in particular. For the US, making the income tax cuts permanent implies more consumption demand, which is likely to widen the trade imbalance, increase the fiscal deficit, and therefore require more sales of US assets and US treasuries. On the other hand, Federal Reserve monetary policy is now moving to a less accommodative stance. For the rest-of-the world, rising current accounts surpluses indicate increasing dependence on net exports, particularly to the US, for growth, rather than growth taking place in response to domestic demand. In addition, going back the last 25 years, whenever there is downward pressure on the dollar coming from private financial markets, foreign central banks have stepped in to purchase US treasuries, thus tending to stymie exchange rate adjustment and therefore promote their countries net export habit.

Changes in policies could ease the world out of this co-dependency, but there is the prisoner’s dilemma of ‘who goes first’ to make the policy adjustment. With no change in policies, how long can ‘business as usual’ proceed? Likely we will see either financial discipline coming in the form of a dollar depreciation or the US consumer will run out of buying power. In either case, economic forces will push toward large shifts in net exports, which will be disruptive to global growth, although likely relatively more disruptive to the rest-of-the-world than to the US.