Macroeconomic Objectives at Odds in the United States

The Trump administration wants to accelerate the economy. A major tax cut was announced, an average of US$1,600 per household, with businesses also getting in on the action. The most recent federal budget agreement provides for an increase of roughly US$400B in public spending, the bulk of which is to occur in 2018 and 2019.

At the same time, the United States is adding protectionist measures to try to reduce the trade deficit, which was US$811B in 2017 in the goods sector. The situation is improving with the US$243B surplus from services. Be that as it may, the most comprehensive measure is that of the current account balance, which also includes net investment income from abroad and other international transfers. In total, the current account posted a deficit of US$466B in 2017, the equivalent of 2.4% of U.S. GDP.

However, efforts to stimulate the economy are at odds with attempts to reduce the trade deficit. The little excess capacity available will hardly be enough to respond to a strong acceleration in demand. In addition to increased inflationary pressure, difficulty boosting production locally risks stimulating imports and halting exports.

This incompatibility can also be observed between the public deficit and the current account deficit. It can be mathematically shown that lower imports and higher public spending may worsen the current account deficit. In reaching this conclusion, we must first split national savings (S) into two components: private savings (Sp) and public savings (Sg). Private savings are gross national income (GNI), less consumption (C), less taxes (T). Public savings are the difference between the government’s income and expenditures (G).

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S = Sp + Sg
\]
\[
S = (GNI - C - T) + (T - G)
\]

In this equation, the GNI can be replaced by the sum of consumption, investment (I), government spending and the current account balance (CA). This new equation can then be reorganized by taking out the terms that cancel each other out and by moving CA to the left.

\[
S = (C + I + G + CA - C - T) + (T - G)
\]
\[
S = I + CA
\]
\[
CA = S - I
\]
\[
CA = Sp + Sg - I
\]

We then see that the current account balance is equal to the difference between an economy’s savings and investment, that is, the share of financing from abroad. Distinguishing private and public savings yet again, we see that an increase in the public deficit will reduce public savings and deteriorate the current account balance. An increase in private savings could offset a rising public deficit, but that would halt advances in consumption. Investment could be slowed as well, but this would also defeat the purpose of stimulating the economy.

IMPLICATIONS

It is difficult to stimulate an economy with little excess production capacity while driving down the current account deficit. The silver bullet would be to sharply raise income in the economy to support both consumption and savings. However, this would require investment in production capacity and higher productivity.

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