THE PER JACOBSSON FOUNDATION

The U.S. Current Account Deficit and the Global Economy

Lawrence H. Summers

Sunday, October 3, 2004
Washington, DC

THE PER JACOBSSON LECTURE

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Foreword

On Sunday, October 3, 2004, a Per Jacobsson Foundation Lecture was presented by Lawrence H. Summers, President of Harvard University and former Secretary of the U.S. Treasury, in the Hall of the Americas of the Organization of American States in Washington. Mr. Summers spoke on "The U.S. Current Account Deficit and the Global Economy."

The lecture was delivered in conjunction with the Annual Meetings of the Boards of Governors of the International Monetary Fund and the World Bank, as is traditionally the case. Per Jacobsson Foundation events, which include not only lectures but also occasional symposia on topics in finance, economic policy, and international cooperation, are also sometimes held in the context of the Annual General Meeting of the Bank for International Settlements (BIS) in Switzerland. This was the case in Zurich in June 2004 when Professor C.A.E. Goodhart of the London School of Economics delivered a lecture on "Some New Directions for Financial Stability?"

The Per Jacobsson Foundation was established in 1964 to commemorate the work of Per Jacobsson (1894–1963) as a statesman in international monetary affairs. Per Jacobsson was the third Managing Director of the IMF (1956–63) and had earlier served as the Economic Adviser of the BIS (1931–56). Per Jacobsson Foundation lectures and contributions to symposia are expressions of personal views and intended to be substantial contributions to the field in which Per Jacobsson worked. They are distributed free of charge by the Foundation. Further information about the Foundation may be obtained from the Secretary of the Foundation or may be found on the website, www.perjacobsson.org.

Opening Remarks

JACQUES DE LAROSIÈRE

It is a great honor and a great pleasure for the Per Jacobsson Foundation today to have the participation of Larry Summers. He doesn't need any introduction because you all know him, and therefore what I'm going to say is going to seem banal and superfluous.

But let me just say that I have great respect for and personal friendship with Larry Summers, who has played an extremely important role in this country. You know that Larry is a Harvard man, if I may say so. He got his Ph.D. and was a professor of economics at Harvard. And, actually, he won a rather interesting award: the Alan T. Waterman Award of the National Science Foundation, which Congress has established to honor an exceptional, young—and this is still true of him—U.S. scientist or engineer whose work demonstrates originality, innovation, and significant impact. Well, I think this encompasses pretty well the personality of Larry. He is original, he is innovative, and he has, indeed, made a significant impact on things.

In 1991, he became Vice-President of Development Economics and Chief Economist of the World Bank, where he played a very significant role in designing strategies to assist developing countries. Then he became Undersecretary of the U.S. Treasury for International Affairs in 1993; and in 1995—remember the Tequila Crisis?—he became Deputy Secretary, and you know the very important role he played in those positions.

And, then, it was in July 1999 that Mr. Summers was confirmed by the Senate as Secretary of the U.S. Treasury, and in that capacity he served as principal economic adviser to President Clinton.

After leaving the Treasury Department in January 2001, Mr. Summers served as the Arthur Okun Distinguished Fellow in Economics, Globalization, and Governance at the Brookings

Institution. And then more recently, in 2001, he became the 27th president of Harvard University, and he has already left an imprint on that prestigious institution.

So, after having said all that, I think our appetite is whetted, and now we will listen with immense interest to what Mr. Larry Summers has to say. Thank you.

The U.S. Current Account Deficit and the Global Economy

LAWRENCE H. SUMMERS

I am deeply honored by the invitation from the Per Jacobsson Foundation to deliver this prestigious lecture and join the list of distinguished lecturers who have been part of this series, and am also very glad to see so many friends and colleagues.

I last had the chance to attend the Annual Meetings in the fall of 2000. Some things have stayed the same, some things have changed. Then there was a close U.S. election, then there was great concern about rising oil prices, then there was a hope of collective efforts regarding debt relief for the poorest countries. These things all give a sense of déjà vu.

But things have also changed. The geopolitical environment is profoundly different than it was at that time and far more preoccupying than it was at that time. And perhaps in part for that reason, the other major difference—the very substantial increase in the pattern of global imbalances in general and in the U.S. current account deficit in particular—is perhaps receiving less attention than it should.

It is this question of global imbalances and the U.S. current account deficit that I want to address this afternoon. The U.S. current account deficit is currently running well in excess of $600 billion at an annual rate, in the range of 5.5 percent of GDP. It represents well over 1 percent of global GDP and absorbs close to two-thirds of the cumulative current account surpluses of all the world's surplus countries. All of these figures are without precedent. The United States has never run such large current account deficits and no single nation's deficit has ever bulked nearly as large relative to the global economy. At a minimum, such a unique imbalance deserves careful scrutiny.

I want to ask, and try to answer, four questions regarding the U.S. current account deficit in my remarks this afternoon. As I sequence the questions, there will be some suggestion as to my answers. First, is the U.S. current account deficit a transient that will self-correct without a major discontinuity in the global economy? Second, is the large and growing U.S. current account deficit a sign of economic vitality or an incipient problem? Third, is the U.S. current account deficit and the associated reliance on official intervention from nations dependent on exports to the United States a desirable or sustainable state of affairs? Fourth, what is to be done?

THE U.S. CURRENT ACCOUNT DEFICIT IN PERSPECTIVE

Let's turn, first, to a simple look at the current account deficit. In round numbers, the United States is importing 16 percent of its gross domestic product, and it is exporting a bit less than 11 percent of its gross domestic product. So exports are about two-thirds of imports, or imports are about 50 percent larger than exports.

This has a disturbing arithmetic implication. If the global economy grows in a completely balanced way, with all imports and exports rising in proportion to the size of the global economy, the U.S. current account deficit deteriorates. Each $1 increase in U.S. exports is associated with an additional $1.50 in U.S. imports. Or, to put the point differently, if over a five-year period, U.S. imports and exports both grow at 6 percent (about in line with historic averages) and the U.S. economy grows at 3 percent, the current account deficit on this account alone will increase by close to 1 percent of GDP. But the situation is actually rather worse than this for what appear to be reasons of population growth and which appear at the current moment to be reasons of structural productivity growth. U.S. economic growth, in fact, significantly exceeds the economic growth rate of the United States's major trading partners, and therefore imports are sucked in by economic growth at a rate that exceeds the impact of foreign economic growth on U.S. exports.

There is yet another consideration, quantitatively probably more important though somewhat more mysterious, pointing in the same direction. For reasons that economists poorly understand, it was first noted in 1969 that the elasticity of U.S. exports with respect to foreign economic growth is less than the elasticity of U.S. imports with respect to domestic economic growth. That is to say, our growth sucks in more imports than their growth sucks in exports. This is known as the Houthakker-Magee effect. Lacking a convincing explanation, economists have predicted that this was some kind of anomaly that would go away in the next 30 years, and it has not, as yet. Consistently, the output elasticity of foreign imports is far less than in the case of American imports. Balanced growth means a deteriorating current account deficit. Growth is likely to be unbalanced in a way that exacerbates the situation. And even with balanced growth, there are likely to be unbalanced impacts on imports and exports.

Taking all this together, one can understand the conclusions that almost all the modelers reach with respect to the evolution of the U.S. current account deficit in the absence of any discontinuities. The most recent such study I had a chance to read is that of Nouriel Roubini and Brad Setser, who predict that, without a discontinuity, the U.S. current account deficit will rise to 6.5 percent of GDP in 2006, and 7.8 percent of GDP in 2008. Using a different model and somewhat different methodology, Catherine Mann predicts a current account deficit that could approach 13 percent of GDP by 2010, without some sort of major discontinuity. Note carefully, these are not forecasts of what will occur—they are predictions of what would happen without discontinuous changes in growth rates, patterns of demand, or relative prices of different countries' output.

There is much that one can argue about in the forecasts and the models, but I'm aware of no credible argument that without some form of discontinuity, the U.S. current account deficit will not increase from its current high level.

INTERPRETING THE U.S. CURRENT ACCOUNT DEFICIT

Second question: Is this current account deficit a sign of vitality or of incipient problems? There is a standard set of things that the finance ministers of countries with significant current account deficits say, suggesting that such deficits are somehow a sign of economic strength. Perhaps the sharpest formulation that I have heard is: "We live in a country that capital is trying to get into. Would you rather live in a country that capital is trying to get out of?"

It is important in examining a current account deficit to understand its roots. Tautologously, a current account deficit is the difference between national savings and national investments; or, equivalently, between net national savings and net national investment, removing the effects of depreciation. It is natural to look at the U.S. current account deficit and ask whether its level and its deterioration is better attributed to increased investment or to reduced saving.

In the last year, the net national savings rate of the United States has been between 1 and 2 percent. That is to say, if one adds personal savings, corporate savings, and government savings—in this case government dissavings—and calculates them as a ratio of NNP, one is left with a figure between 1 and 2 percent. This represents a substantial deterioration over the last five years. It represents the lowest net national savings rate in American history, and I believe that of any major nation. At 1.5 percent, the national savings rate is about half of what it was in the late 1980s and early 1990s, when national saving was last a major item on the U.S. policy agenda. In fact, net investment has declined over the last four or five years in the United States, suggesting that all of the deterioration of the current account deficit can be attributed to reduced savings and increased consumption rather than to increased investment.

A second question that one asks in looking at a large current account deficit in the classic emerging market context is whether that investment which is taking place is taking place in the traded goods sector, where it is generating the export capacity that can ultimately service debt, or whether investment is being allocated increasingly to the non–traded goods sector. Here, too, the record is clear: an unusual interest rate environment and heavy foreign competition in manufacturing have changed the composition of investments in the United States substantially toward the non–traded goods sector as manifested particularly clearly in the dramatic increases in the price of residential real estate in and around most major American cities.

There is another way to look at this constellation of issues: in terms of the type of capital inflows which are financing the current account deficit. Here, too, there is much that one can cavil about. There are significant discrepancies that some people in this room probably understand, but I do not, between BIS figures on central bank accumulation of reserves and U.S. Bureau of Economic Analysis figures on official financing of the current account deficit.

But the dominant picture, it seems to me, is quite clear. Brad Setser calculates from the most recent BIS annual report that the central bank reserves of Asia, inclusive of Japan, increased from about $1.1 trillion to about $1.8 trillion from the end of 2001 to 2003—a $700 billion increase in reserves—with Japanese reserves increasing by $265 billion, Chinese reserves by $191 billion, Indian reserves by $52 billion, and the reserves of the newly industrialized economies of Asia by $163 billion. The reserves of Taiwan are in excess of the reserves of all of Latin America.

The evidence from this year is less clear, and there is some suggestion in the data that the extent of reserve accumulation may have tailed off somewhat. But the basic picture that a large fraction of the U.S. current account deficit is being financed by foreign central bank intervention is not one that can be argued with.

There are different ways of describing this system. Michael Dooley, Peter Garber, and David Folkerts-Landau have referred to it as a kind of new Bretton Woods system. Catherine Mann has described it as codependency. Another term for it is "international vendor finance." It is, I think, relatively clear what is going on. A substantial number of countries are maintaining a fixed or quasi-fixed exchange rate through very substantial exchange rate intervention and enjoying strong export performance to the United States as a result. It was the common advice and, in my judgment, the correct advice and the correct lesson to learn from the experiences of the mid-1990s and the late 1990s, that emerging market countries could profitably have more reserves than was formerly thought to be the case, and that the capacity to roll your own massive IMF program from reserves was something on which policymakers could sensibly put a premium. I believe we are well past the point in many countries where reserve accumulation can sensibly be attributed to a prudent insurance motive with respect to the prospect of future financial crisis.

Nor, looking at the interest rate held on these reserves—which is negative in real dollar terms and negative in local currency terms—if an appreciation lies in the future, is it reasonable to suppose that the primary motivation for the accumulation of these reserves is that it represents the highest-value investment opportunity open to the societies that are investing on such a scale in these reserves. Large current account deficits are likely to grow, replacing declining saving with substantial finance from abroad coming through the official sector.

The next question to ask is whether an arrangement of this kind is desirable, if it can be maintained, and, if desirable in some elements, is likely to be sustainable over the medium and the long term. I have already hinted at some of the concerns. Consider, first, whether it is desirable if it could be maintained. For the United States, an arrangement of this kind, even if it could be maintained indefinitely, carries with it two very substantial risks. One risk is the incipient protectionist pressures that are generated by a large trade deficit, and a trade deficit that is associated with financial practices that have as part of their motivation the promotion of exports. There is no question, in my judgment—and it's a judgment I came to painfully but fairly confidently—that protectionist pressure in the United States is on an upwards trend. You see it in political debates over trade. You see it in the current furor over outsourcing, which commands so much attention in this political year.

The second risk of a system of this kind, even if it could be maintained for a significant number of years, is a more amorphous one but one that is no less serious. Inevitably, dependence on foreign governments for short-term financing has to raise questions and create vulnerabilities in both the economic and political realms. The question can fairly be asked: How long should the world's greatest debtor remain the world's largest borrower? I have previously used the term "balance of financial terror" to refer to a situation where we rely on the costs to others of not financing our current account deficit as assurance that financing will continue. The term may overdramatize the problem, but this is surely a situation of concern.

If these arrangements are problematic, even if they could be maintained for the United States, what of the countries that are providing finance on a substantial scale to the United States with respect to the current account deficit and the maintenance of their exchange rates? Here, too, there are two substantial questions of desirability, even apart from the question of sustainability. A great deal of money is being invested at what is almost certainly a very low rate of return. To repeat, the interest earned in dollar terms on U.S. short-term securities is negative. If even a modest appreciation of a country's currency lies in the future, the valuation losses on reserves will be quite substantial in local terms.

Second—and the significance of this will vary from country to country—there is, as always with fixed exchange rate regimes, the loss of domestic monetary control and the difficulty of maintaining monetary policy in response to domestic conditions. One sees this very clearly, particularly in the Chinese case where the external constraints exert an important impact on domestic monetary policy. It is noteworthy that much of the speculative bubble in Japan during the late 1980s that had such a catastrophic long-run impact on the Japanese economy was driven by liquidity produced by a desire to avoid excessive yen appreciation.

The current system is also problematic for Europe. With a limited number of currencies that are flexible against the dollar, the flexible currencies will bear disproportionately the impact of any changes in sentiment regarding dollar assets.

This, then, is an arrangement that is not without its virtues—low-cost finance for America at a time when savings are low, strong exports and a very competitive traded goods sector for those who are providing the finance—but it is one that also has very important costs. And then there is the question of the sustainability of the arrangements.

The comparison is made to the Bretton Woods regime, but as Barry Eichengreen notes in his very perceptive paper on this subject, the Bretton Woods regime did end. The Bretton Woods regime took place at a time when the United States had a current account surplus, not a current account deficit. And the Bretton Woods regime took place in an era of substantially less capital mobility than the one we expect—and the one we enjoy—today.

When and in what way does this regime of rising current account deficit increase U.S. debt reliance on official sector finance? Whether it will end on its own accord is impossible to predict, but I would suggest that if one is seeking to draw lessons from the last 15 years of monetary experience, here is one that is very powerful: fixed exchange rates with heavy intervention have enormous capacity to create an illusory sense of stability that could be shattered very quickly. That is the lesson of Britain in 1992, of Mexico in 1994, of emerging Asia in 1997, of Russia in 1998, and of Brazil in 1998.

To be sure, there are important differences between exchange rates that are being protected against pressure for depreciation and exchange rates that are being protected against pressure for appreciation. But the basic point, I believe, remains the same: governments find that a calculus of costs and benefits that weighs political costs highly does not support an adjustment of an ultimately unsustainable exchange rate, absent crisis or financial pressure to do so. By the time adjustment can be justified, it is too late, and the costs, when the adjustment takes place, are very serious. This is a movie we have seen many times in the international financial system: large current account deficits, current account deficits that replace savings and are financed officially in a system that is uneasy in its consequences and unlikely to endure indefinitely as debt accumulates.

OBSERVATIONS ON THE ROAD AHEAD

What is to be done?

There is the strategy of averting one's gaze, of not seeking to raise questions, of hoping that the flows will continue, and waiting until the day when they don't. I would suggest that this is a risky course. It is not a course whose consequences are easy to predict when there will be a problem, if there will be a problem in the next several years, whether the problem will take the form of a need to raise interest rates sharply in the United States, a dramatic increase in protectionist pressures, difficulties of monetary control in the Asian economies. None of these can be predicted with confidence, but it seems to me that the risk of adverse consequences along the road is such that it is prudent to think about managing the situation in some planned way.

What, then, do I have to recommend in terms of what is to be done?

Of course, one of the great glories of being an academic rather than a policymaker is that one doesn't have quite the same obligation to pose specific remedies, that one can take refuge in exhorting others like those in this room. But I would make five observations with respect to what is to be done.

The first thing I would say is that I will have served my purpose and achieved my objective if I have stimulated thought about the fact that there is a major issue here of exit from this regime that needs extensive consideration, and I am more confident of that conclusion than I am of any other particular conclusion that I'm going to offer.

Second: It seems to me that if these matters are to be reflected upon internationally—and for reasons I will make clear in just a moment, I believe they are matters that require global rather than just domestic consideration—it is unlikely that the G-7 is the appropriate grouping for the totality of that reflection. The G-7, after all, is made up of the United States, Japan, Canada, and four European nations, and the largest part of the current account deficit that is of concern, and of the exchange rates that are fixed or quasi-fixed—the international vendor finance that I referred to—are coming from outside of the G-7.

It would be my hope that reflection would take place in global fora, and it would seem to me that we have come rather more quickly than I had expected in the late 1990s when I was involved in the establishment of the G-20 Group to a situation where the G-20 can consider issues of global economic coordination that are not predominantly about what industrial countries are going to do to bail out emerging market countries that are in trouble, but rather with respect to the overall global economic strategy for sustained growth.

Third observation: A significant increase in U.S. national savings is a necessary but not a sufficient response to the imbalances that I have described. It is a necessary response because it is difficult to imagine an adequate rate of U.S. investment or an appropriate rate of interest in the United States with 1.3 percent or anything close to it in net national savings, and the removal of substantial foreign official finance.

It is surely a concomitant of a healthy adjustment in the U.S. current account deficit that national savings increase, but it is not a sufficient response to the global imbalance. After all, a current account deficit can decrease for only two reasons: it can decrease either because of a change in the quantity of goods demanded in the country in question or because of a change in their relative price. A moment's calculation will reveal that any attempt to adjust a large part of the U.S. current account deficit by simply slowing down growth in the U.S. economy will involve a slowdown in growth that would be unacceptable in the United States and would have very severe consequences for growth globally. Therefore, an appropriate adjustment must also involve a change in their relative price.

There is no mechanism through which an increase in U.S. national savings will lead to an adjustment if quasi-fixed exchange rate policies are maintained by a substantial fraction of the United States's major trading partners. Indeed, the impact of an increase in the U.S. national savings, with no other change, could be a need for greater intervention and greater official finance with greater monetary consequences for the nations that are seeking to peg their exchange rates.

Fourth observation: An additional concomitant of a healthy strategy must be some adjustment and, I believe, coordinated adjustment of exchange rates that are currently quasi-fixed to the dollar. The argument is sometimes made that the current system runs the risk of pressure arising for its end, not unlike the pressures that arose at the end of the Bretton Woods system, where some nation will weary of holding and accumulating dollar assets, given what they judged to be the low expected returns, and will make a currency adjustment, and then others seeing the handwriting on the wall will follow. That is one aspect of the situation.

Another aspect, which I would guess looms larger, is that unilateral exchange rate adjustments will run into very substantial competitive pressures against those who allow a unilateral exchange rate appreciation. And so exchange rate appreciation is likely to be more politically acceptable and more economically acceptable if it does not take place unilaterally but takes place in a coordinated fashion. This, too, is a remedy that doesn't work very well on its own, and exchange rate adjustment in Asia and an associated substantial reduction in foreign purchases of U.S. treasury bills would put American interest rates and the American recovery at significant risk with, again, risks to the global economy.

When one thinks about this problem carefully, I think one decides that both elements of the necessary adjustment process—an increase in U.S. national savings and an adjustment of currently fixed exchange rates—are much easier and much healthier with the complementary measure, and that is of course the classic case for policy coordination: when measures which are desirable taken jointly are risky taken individually. It would be my hope that in the not-too-distant future, through some set of discussions, through some set of coordination, tacit or explicit, we find our way to such a set of adjustments.

To be sure, there is enormous short-run functionality and comfort in the current system, but it seems to me that our experience with current account deficits of this kind, on the one hand, and quasi-fixed exchange rates, on the other, suggests that it is healthiest to make adjustments before, rather than after, there is great pressure to do so.

Thank you very much.

Questions and Answers

Following the formal presentation, Mr. Summers took questions from the audience.

MR. SUMMERS: I would be delighted to take a few questions. As I do, I should probably say now what I have assumed all along and perhaps could have said at the beginning, that any views that I have expressed here are my own views and should not be attributed to any other American or any other institution.

Question: My question is in two parts. First, given the strong growth of the U.S. economy and associated high returns to investment there, surely central banks are not being so irrational if they concentrate their reserves in U.S. assets? Second, how can you speak so generally about "quasi-fixed" exchange rates in Asia, given that this description really only applies to China?

MR. SUMMERS: The second part of the question was about whether it was really right to speak with the strength that I did about quasi-fixed exchange rates, given that it was really only China that had a fixed exchange rate and the others did not. Here I would take refuge, but confident refuge, in my use of the word "quasi." It becomes a matter of semantics with a nonfixed exchange rate in which intervention is used as a heavy and substantial tool to maintain very low volatility around a certain level as to what type of exchange rate regime that is. If one looks at the various examples I gave of what I called "quasi-fixed exchange rates" that came to grief in the 1990s, two-thirds of them had monetary authorities who would explain how they weren't really fixed exchange rates, if you thought about them right. For example, they were bands, and they had got to the edge of the bands. But I think it was a good de facto description of what was going on. Without trying to debate it country by country, I would insist on my broad characterization.

The other part of your question was whether, with the United States growing fast, its assets must have a high return, and also it's got a terrifically liquid market, isn't it clearly the right thing for the central bankers to invest in dollars? Here I would say two things. I certainly would not want to suggest how you or any other central banker should manage your reserves, but I would point out that when you buy U.S. treasury bills, what you get is 1.75 percent, and it doesn't really matter whether the U.S. economy grows rapidly or grows slowly. And that is, as I said, a negative interest rate in real dollar terms, and I think that's the number that one should focus on.

And I guess the question I would ask is: If one looks at societies that, after all, on a global standard, are capital-poor, that constantly present themselves to international development agencies as having a wide range of projects available to them with very high rates of return, one has to wonder why a significant fraction of national wealth is being invested at what is almost certainly a close-to-zero rate of return. And that's what lies behind this kind of very large accumulation of reserves.

Question: I would like to know how you view the role of the deficit in public finances in current account deficits.

MR. SUMMERS: The question was what about public finance deficits and current account deficits. I rooted my explanation of current account deficits significantly in reduced national savings. And if one looks at the figures on national saving in the United States, what one sees is two phenomena. One is a secular downward trend in the rate of private savings. That isn't very well understood but it is very pronounced. I suspect it has to do with the far greater ease of private sector dissavings as it gets easier and easier to borrow money on credit cards and second mortgages and the like. And then one sees a substantial swing in the position of the public sector between the year 2000 and the present time, which, in an arithmetic sense, contributes to national savings.

I think you will find near-universal agreement among economists that the most potent and reliable way to increase national savings is to reduce government dissavings. And, so, when I referred to the importance of increasing national savings, certainly fiscal consolidation is the most direct route toward the achievement of that objective.

Question: What would the effect be on the U.S. current account deficit if most, as distinct from some, of the work done by women, in caring for children and elderly parents, for the home and partners and voluntary work in the community, was substituted by immigrant labor and their consequent remittances to families abroad?

MR. SUMMERS: I tried to think about what questions I would be asked after my remarks, and I tried to anticipate what answers I would give, and I would have to say that I'm on my own here because I didn't plan for that question.

I would not presume to attempt a very precise answer. The only thing I would say is every time I had occasion to look at the data on remittances, if you look for phenomena that are very important in the real world and barely considered in economics textbooks and economic models, remittances would be high up on that list, and so I suspect that any very substantial change in immigration patterns would have surprisingly large impacts on current account deficits, but that's as much as I'm prepared to say.

Question: First, do you see any link between the NAFTA agreement and the worsening of the current account deficit here? A second question would be, Do you see any link between the current account deficit and the strong-dollar policy that was for a long time the policy of the United States, and what kind of dollar policy would you advise today when you have a worsening of current account deficit? Finally, I have read somewhere that the manufacturing sector in the United States is only 16 percent of the U.S. economy; given that, do you believe that there is any possibility of correcting the current account deficit? I mean, of having more exports without a bigger manufacturing sector?

MR. SUMMERS: I feel like I'm taking my oral exam! On your three questions, with respect to NAFTA and the U.S. current account deficit, I would plead NAFTA completely innocent. The current account deficit is driven much more by the phenomena of savings and investment. And, in fact, if one looks at the trade agreements the U.S. has entered into, the reduction in foreign trade barriers far exceeds any reductions in U.S. trade barriers because the U.S. economy went into those agreements already much more open.

Your second question was about the strong-dollar policy. Well, the strong-dollar policy is an expression of what seems to me to be a very fundamental principle of national economic management, and that is that the strategy of artificially devaluing a currency to seek competitive or commercial advantage is, for a major industrial economy, an unsound policy that carries with it risks that are not commensurate with its benefits, and it seems to me that the strong-dollar policy understood in that way should be a constant in the policy of the United States. That is not to exclude the recognition that there may be occasions on which other countries' currencies should, for either their own domestic reasons or reasons linked to the global system, be allowed to fluctuate.

Question: I think you are guilty of wild optimism when you talk about governments dealing with a long-term problem. A long-term problem for the government is next Wednesday or, at most, next Thursday. To think these governments would look as far ahead as you suggest seems unrealistic. And, in fact, most new ideas come from the private sector people like yourself, Jacques de Larosière, and Paul Volcker, who have examined a problem and then made a report to the government for the government and the people about this issue. What's your view on that?

MR. SUMMERS: The questioner expressed the view that governments are unlikely to take on long-term challenges and are likely to gravitate to the expedient and the short term—a view that is certainly suggested by the variety of examples that I gave with respect to overly long-maintained exchange rates. He also raised the question of why I would be hopeful that suggestions such as the ones I made would be adopted—well, hope springs eternal, I suppose—and also the question of whether it was useful and helpful, as I believe it is, for private citizens to participate in the dialogue and the process of opinion formation on these issues, and I believe that does ultimately have an important impact on governments. And I believe that's the reason, frankly, why what the Per Jacobsson Foundation has done for

40 years is so important—what is actually so important about these meetings.

There are two things that happen at these meetings. One is there are agreements reached on specific things and communiqués issued, and the other is that hundreds of people talk and argue with hundreds of other people about these issues and what is to be done and what is the right way to understand them. And out of that comes improved understanding, changes in the zeitgeist, and that is ultimately what drives policy. And discussions, like the one we are all having here, are an important part of that process. There may be ways in which in some situations it can be formalized. Certainly, the work you have done through the Bretton Woods Committee has been helpful at a number of junctures in influencing the zeitgeist, which, in turn, influences policy.

But I believe that the famous passage from Keynes about how everything statesmen do is really the distilled frenzy of a forgotten scribbler needs to be updated: that the basic thought that what policymakers are responding to is the climate of ideas is exactly right, but in the world of Blackberries and e-mails, it's less the distilled frenzy of a scribbler from decades ago and more the facts that come from a think tank. But these kinds of discussions actually are very, very valuable. Whether anything I have said today has particular merit or not, I think these kinds of discussions actually make a very big difference.

Question: You suggested a set of two actions: one, an increase in U.S. national savings, the other, the adjustment of the exchange rates in the quasi–fixed rate countries. It sounds very attractive, but I have one question. The question is that the first action, to increase U.S. national savings, seems to take a long time, whereas the adjustment of the exchange rate can take immediate effect. How do you comment on this mismatch in the time required to take effect for those two actions?

MR. SUMMERS: It's a terrific question. I suppose there are three answers that I would give to it, but it is a very important issue. The first is that some significant part of what's important about increasing national savings happens if there is an incipient increase in national savings that can be expected to be delivered in the future. So, if one looks at what happened in the United States in 1993 and 1994, there was through the passage of an economic program in 1993 a rather discontinuous change in the sense of sustainability, even before all of the measures were implemented. So, the first point is, we have a capacity for multiyear budgeting in the United States, and the expectation of forward savings rates casts a shadow backwards.

The second answer that I would give is that I was consciously rather vague about the nature of the exchange rate adjustments that were appropriate, and that was frankly because I wasn't certain that I knew what the right arrangement was. There are obviously a multiplicity of modes that one could imagine on a spectrum from a repegging at a different level to a float, to an adjustment followed by a float, to a float within a band, to a float that is substantially managed. And it would depend upon the constellation of circumstances in which an agreement was being reached, and a variety of issues in the particular context, just what the right form would be.

But, if you think about most of the options that I just described, they would allow for the exchange rate adjustment to be more continuous. That is to say, if it was simply a repegging, your problem would arise in a very powerful way. If one imagined, as I suspect is more appropriate, an upwards adjustment that was both upwards and with more flexibility, the question of timing, in a sense, manages itself rather more.

I guess the third thing that I would say is that I think the consideration you adduce complicates the process but, in a way, doesn't eliminate my argument because it seems the crux of the argument I'm making is that exchange rate adjustment, without any change in U.S. national savings, is not likely to be healthy, and a change in national savings that reduces U.S. demand without any expenditure-switching policy is likely to be unhelpful. So, even if the matching is imperfect, some matching is better than none.

MR. DE LAROSIÈRE: Thank you very much, Larry. I would like to thank you for the superb lecture you have given us. It has lifted our minds. I think it's an extraordinary performance you have given, and it's really the kind of global exercise, and global thinking, that we all need. So I would like you to accompany me in applauding our speaker.

Now I have two pleasant announcements to make; they're going to be very brief. The first one is that you are all invited to the reception at the lower floor of this building. And the second one is that I will be succeeded in this position of Chairman of the Per Jacobsson Foundation by Andrew Crockett, and I think this is very good news. I have reached, indeed, the age of 75 years old, which is the limit in our Articles of Agreement to serve as the chairman. So it's with great pleasure that I announce that from now on it's Andrew who is going to chair these meetings. All the best, and thank you for coming.

Lawrence H. Summers

Lawrence H. Summers took office as the 27th president of Harvard University on July 1, 2001. Mr. Summers is the former Nathaniel Ropes Professor of Political Economy at Harvard, and in the past decade has served in a series of senior public policy positions, most recently as Secretary of the U.S. Treasury.

Mr. Summers received a bachelor of science degree from the Massachusetts Institute of Technology in 1975, following which he began his Harvard career as a doctoral student in economics. In 1979, he was appointed assistant professor in the economics faculty and, in 1982, was awarded a Ph.D. and also appointed associate professor. He then went to Washington as a domestic policy economist for the President's Council of Economic Advisers.

In 1983, he returned to Harvard as a professor of economics, one of the youngest tenured members of the university's faculty in recent history. While on the faculty, he taught undergraduate and graduate courses in macroeconomics and public finance and was an adviser to numerous graduate students who have themselves gone on to become leading economists. He also served as an editor of the *Quarterly Journal of Economics.*

In 1987, Mr. Summers became the first social scientist to receive the annual Alan T. Waterman Award of the National Science Foundation (NSF), established by Congress to honor an exceptional young U.S. scientist or engineer whose work demonstrates originality, innovation, and significant impact. In 1993, Mr. Summers was awarded the John Bates Clark Medal, given every two years by the American Economic Association (AEA) to an outstanding American economist under the age of 40.

Mr. Summers took leave from Harvard in 1991 to return to Washington, this time as Vice-President of Development Economics and Chief Economist at the World Bank. In that position, he played a key role in designing strategies to assist developing countries; served on the bank's loan committee; and guided the bank's research, statistics, and external training programs.

In 1993, Mr. Summers was named Undersecretary of the U.S. Treasury for International Affairs and, in 1995, Deputy Secretary. During this time, Mr. Summers played a central role in a broad array of economic, financial, and tax matters, both international and domestic, and worked closely with Secretary Rubin and Alan Greenspan, Chairman of the Federal Reserve System, in crafting government policy responses to financial crises in major developing countries.

On July 2, 1999, Mr. Summers was confirmed by the Senate as Secretary of the U.S. Treasury. In that capacity, he served as the principal economic adviser to President Clinton and as the Chief Financial Officer of the U.S. government. At the end of his term as Treasury Secretary, Mr. Summers was awarded the Alexander Hamilton Medal, the Treasury Department's highest honor.

After leaving the Treasury Department in January 2001, Mr. Summers served as the Arthur Okun Distinguished Fellow in Economics, Globalization, and Governance at the Brookings Institution in Washington.

Mr. Summers's many publications include *Understanding Unemployment* (1990) and *Reform in Eastern Europe* (1991, coauthored with others), as well as more than 100 articles in professional economics journals. He also edited the series *Tax Policy and the Economy.* In 2000, Mr. Summers presented the AEA's prestigious Ely Lecture, "International Financial Crises: Causes, Preventions, and Cures." In 2002, Mr. Summers was elected to the National Academy of Sciences, a private organization of scientists and engineers dedicated to the furtherance of science and its use for general welfare.

Born in New Haven, Connecticut, on November 30, 1954, Mr. Summers spent most of his childhood in Penn Valley, Pennsylvania, a suburb of Philadelphia.

The Per Jacobsson Lectures

2004 *The U.S. Current Account Deficit and the Global Economy*. Lecture by Lawrence H. Summers.

Some New Directions for Financial Stability? Lecture by C.A.E. Goodhart, CBE (Zurich).

2003 *The Arab World: Performance and Prospects*. Lecture by Abdlatif Yousef Al-Hamad (Dubai).

2002 *The Boom-Bust Capital Spending Cycle in the United States: Lessons Learned*. Lecture by E. Gerald Corrigan.

Recent Emerging Market Crises: What Have We Learned? Lecture by Guillermo Ortiz (Basel).

2001 No lecture took place due to the cancellation of the Annual Meetings of the IMF and the World Bank.

2000 *Ten Years On—Some Lessons from the Transition*. Lecture by Josef Tošovský (Prague).

Strengthening the Resilience of Financial Systems. Symposium panelists: Peter B. Kenen, Arminio Fraga, and Jacques de Larosière (Lucerne).

1999 *The Past and Future of European Integration—A Central Banker's View*. Lecture by Willem F. Duisenberg.

1998 *Managing the International Economy in the Age of Globalization*. Lecture by Peter D. Sutherland.

1997 *Asian Monetary Cooperation,* Lecture by Joseph C.K. Yam, CBE, JP (Hong Kong).

1996 *Financing Development in a World of Private Capital Flows: The Challenge for International Financial Institutions in Working with the Private Sector*. Lecture by Jacques de Larosière.

1995 *Economic Transformation: The Tasks Still Ahead*. Symposium panelists: Jan Svejnar, Oleh Havrylyshyn, and Sergei K. Dubinin.

1994 *Central Banking in Transition*. Lecture by Baron Alexandre Lamfalussy (London).

Capital Flows to Emerging Countries: Are They Sustainable? Lecture by Guillermo de la Dehesa (Madrid).

1993 *Latin America: Economic and Social Transition to the Twenty-First Century*. Lecture by Enrique V. Iglesias.

1992 *A New Monetary Order for Europe*. Lecture by Karl Otto Pöhl.

1991 *The Road to European Monetary Union: Lessons from the Bretton Woods Regime*. Lecture by Alexander K. Swoboda (Basel).

Privatization: Financial Choices and Opportunities. Lecture by Amnuay Viravan (Bangkok).

1990 *The Triumph of Central Banking?* Lecture by Paul A. Volcker.

1989 *Promoting Successful Adjustment: The Experience of Ghana*. Lecture by J.L.S. Abbey.

Economic Restructuring in New Zealand Since 1984. Lecture by David Caygill.

1988 *The International Monetary System: The Next Twenty-Five Years*. Symposium panelists: Sir Kit McMahon, Tommaso Padoa-Schioppa, and C. Fred Bergsten (Basel).

1987 *Interdependence: Vulnerability and Opportunity*. Lecture by Sylvia Ostry.

1986 *The Emergence of Global Finance*. Lecture by Yusuke Kashiwagi.

1985 *Do We Know Where We're Going?* Lecture by Sir Jeremy Morse (Seoul).

1984 *Economic Nationalism and International Interdependence: The Global Costs of National Choices*. Lecture by Peter G. Peterson.

1983 *Developing a New International Monetary System: A Long-Term View.* Lecture by H. Johannes Witteveen.

1982 *Monetary Policy: Finding a Place to Stand.* Lecture by Gerald K. Bouey (Toronto).

1981 *Central Banking with the Benefit of Hindsight.* Lecture by Jelle Zijlstra; commentary by Albert Adomakoh.

1980 *Reflections on the International Monetary System.* Lecture by Guillaume Guindey; commentary by Charles A. Coombs (Basel).

1979 *The Anguish of Central Banking.* Lecture by Arthur F. Burns; commentaries by Milutin Ćirović and Jacques J. Polak (Belgrade).

1978 *The International Capital Market and the International Monetary System.* Lecture by Gabriel Hauge and Erik Hoffmeyer; commentary by Lord Roll of Ipsden.

1977 *The International Monetary System in Operation.* Lectures by Wilfried Guth and Sir Arthur Lewis.

1976 *Why Banks Are Unpopular.* Lecture by Guido Carli; commentary by Milton Gilbert (Basel).

1975 *Emerging Arrangements in International Payments: Public and Private.* Lecture by Alfred Hayes; commentaries by Khodadad Farmanfarmaian, Carlos Massad, and Claudio Segré.

1974 *Steps to International Monetary Order.* Lectures by Conrad J. Oort and Puey Ungphakorn; commentaries by Saburo Okita and William McChesney Martin (Tokyo).

1973 *Inflation and the International Monetary System.* Lecture by Otmar Emminger; commentaries by Adolfo Diz and János Fekete (Basel).

1972 *The Monetary Crisis of 1971: The Lessons to Be Learned.* Lecture by Henry C. Wallich; commentaries by C.J. Morse and I.G. Patel.

1971 *International Capital Movements: Past, Present, Future.* Lecture by Sir Eric Roll; commentaries by Henry H. Fowler and Wilfried Guth.

1970 *Toward a World Central Bank?* Lecture by William McChesney Martin; commentaries by Karl Blessing, Alfredo Machado Gómez, and Harry G. Johnson (Basel).

1969 *The Role of Monetary Gold over the Next Ten Years.* Lecture by Alexandre Lamfalussy; commentaries by Wilfrid Baumgartner, Guido Carli, and L.K. Jha.

1968 *Central Banking and Economic Integration.* Lecture by M.W. Holtrop; commentary by Lord Cromer (Stockholm).

1967 *Economic Development: The Banking Aspects.* Lecture by David Rockefeller; commentaries by Felipe Herrera and Shigeo Horie (Rio de Janeiro).

1966 *The Role of the Central Banker Today.* Lecture by Louis Rasminsky; commentaries by Donato Menichella, Stefano Siglienti, Marcus Wallenberg, and Franz Aschinger (Rome).

1965 *The Balance Between Monetary Policy and Other Instruments of Economic Policy in a Modern Society.* Lectures by C.D. Deshmukh and Robert V. Roosa.

1964 *Economic Growth and Monetary Stability.* Lectures by Maurice Frère and Rodrigo Gómez (Basel).

The Per Jacobsson lectures from 1979 through 2004 are available on the Internet at www.perjacobsson.org, which also contains further information on the Foundation. Subject to availability, copies of the Per Jacobsson lectures from 1990 through 2004 may be acquired without charge from the Secretary. The Per Jacobsson lectures from 1964 through 1978 may be obtained for a fee from the ProQuest Company, 300 North Zeeb Road, Ann Arbor, MI 48106-1346; Tel: (734) 761-4700 or (800) 521-3042; Fax: (734) 761-3940 or (800) 864-0019.

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