Dangers in Britain's poor traded output and current account deficit

From Mr John Wells.

Sir, Financial deregulation and optimistic expectations certainly fuelled the boom in domestic spending which contributed to the sharp deterioration in the current account balance at the end of the 1980s. But maybe Samuel Brittan errs (Economic Viewpoint, June 27) by ignoring the weak performance of the supply side of the economy during the 1980s, which remains a cause for concern – especially that of *traded* output.

Though traded output is difficult to measure directly, inferences can, nevertheless, be drawn from the following indicators. Manufacturing output (with its high traded component) is now just 4.2 per cent higher than in 1979; exports of commercial services (merchant shipping, aviation, travel, financial and other services) are just 5.6 per cent higher, by volume, than in 1979; output from the North Sea is just 12.1 per cent higher.

These paltry increases must be compared with a growth in domestic expenditure, which, though insufficient to attain full employment, amounted to 29.2 per cent relative to 1979 – a rough guide to the growth of domestic spending on traded goods and services.

It is on the basis of this extremely unbalanced performance between the growth of traded output and expenditure that Samuel Brittan calls for "another decade of Thatcherism" – a philosophy peculiarly obsessed with the performance of the non-traded parts of the economy (public utilities, health, education) but which left the crucial traded sector to fend for itself in increasingly competitive markets.

Drawing down the country's net assets to sustain a rise in domestic spending which was totally disproportionate to the underlying growth of traded output hardly rates as an "achievement" we can afford to repeat.

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From Mr Gerard Lyons.

Sir, Samuel Brittan is wrong to downplay the importance of the UK's sizeable current account deficit. It is important to realise that the deficit reflects structural problems; hence it remains so stubbornly high even in recession. This is a symptom of the UK's low level of savings and of investment, particularly in the tradeable goods sector – the manufacturing base.

As a result, the UK fails to produce sufficient high-quality goods to satisfy domestic demand. Hence high import penetration. Furthermore, the UK's lack of capacity and lack of investment in high value-added areas means that it fails to satisfy demand in high-income export markets.

This points either to a significant devaluation of sterling or to domestic demand growing at below its trend rate for some considerable period.

Mr Brittan makes much of the lack of response of the bilateral UK-German interest rate differential to the current account deficit. This is not unexpected as:

- the UK's running down of its overseas assets has partially offset the need to attract overseas capital; overseas borrowing has tended to be mainly short-term capital which could be repatriated at little notice;
- crucially, the current account deficit has not implied an immediate sterling depreciation, primarily because the adjustment has occurred through a tight policy stance that has squeezed the domestic real economy.

However, at some stage soon the persistence of the current account deficit could easily force a significant rise in the UK's interest rate risk premium.

This is likely to occur once the markets realise fully that the present adjustment to the deficit has failed to address any of the underlying structural problems.

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