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Deficit rule No. 1: If you're in a hole, stop digging

By Pat M. Holt

ASHINGTON - Bad economic news presses from all sides. The recovery is faltering. The stock market is in a funk. Consumers are being squeezed between stagnant incomes, rising costs of buying credit, and maxed-out credit cards.

Deficits of all kinds are growing. The federal budget deficit is projected at $5 trillion (that's trillion, as in 5,000,000,000,000) over the next 10 years. The federal government's unfunded liabilities, mainly for retirement and healthcare, are $72 trillion. This will show up later in budget deficits as the baby-boomer generation ages. The trade deficit - the difference between what the US exports and what it imports - was $46 billion in May, the latest month for which figures are available. That's a rate of $552 billion a year, the measure of the obligations to foreigners incurred by the US.

Doing something about the budget deficit and its cousin, the unfunded liabilities, is simply being put off in the hope that they will go away until somebody else is in charge.

The trade deficit is more troublesome. It exists because the US buys more abroad than it sells. Part of this comes from the high price of oil, but part also comes from the desire of Americans to have German cars, Japanese electronic gadgets, Scotch whisky, and other luxury goods from various countries. The imbalance is reflected in the value of the dollar in foreign-exchange markets. It takes more dollars to buy a euro (and therefore a German car), and fewer euros to buy a dollar. This difference is financed by foreign investments in the US - Treasury bonds or other US assets (real estate, for example).

A weak dollar makes US exports cheaper and imports more expensive. Exports increase, imports decrease, and eventually the trade deficit comes into balance. This process is painful. Given the size of the US economy and the volume of US foreign trade, an international imbalance such as we now see is not simply an American problem; it is a world problem. If foreigners stop buying or start selling their holdings of dollars, then there is a worldwide financial crisis.

There is one further deficit that is perhaps the most troublesome of all. American labor has raised a big fuss about what it calls the export of jobs under NAFTA (the North American Free Trade Agreement) and other free-trade agreements.

It is cheaper for American companies to manufacture or assemble their products in third-world countries (such as Mexico, those in Central America, and some in Asia) than in the US. Labor costs are lower, and environmental regulations are less stringent. The savings are not only in wages but also in fringe benefits, especially health insurance and retirement.

Now, cost-conscious companies have found a way to use technology to perform service, as well as manufacturing, jobs in third-world countries that have an educated middle class.

India is the prime example. So far, perhaps a million Indians with college degrees in the southern state of Tamil Nadu are maintaining databases in the computers of large American corporations - at a fraction of the cost of doing it in the US. A recent study by the University of California at Berkeley suggests that as many as 14 million jobs may be involved in a few years.

Nor is this all. X-rays taken in the US are sent to India for radiologists to interpret. Patients' insurance claims and questions of Medicare eligibility are sent there too. Even US tax returns are made out.

Anything that can be done on a computer in the US can be done as quickly and a good deal more cheaply in India.

This is giving a new meaning to globalization. It is hard to see what, if anything, can or should be done about it; but it portends massive changes in the world economy.

Meanwhile, what is to be done about the more mundane problems of deficits?

• Rule No. 1: When you are in a hole, stop digging. Stop making the deficit worse by reducing the government's income through tax cuts.

• Rule No. 2: If you are going to fight a war, don't try to do it, as President Bush has done, on the cheap. Give the country a sense of commitment and sacrifice. Don't urge people to spend more for the sake of the economy. Urge them to save more for the sake of the war effort.

• Rule No. 3: If it's an election year, call up again the slogan that was in the Clinton war room in 1992: "It's the economy, stupid!"

• *Pat M. Holt is former chief of staff of the Senate Foreign Relations Committee.*

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