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A World Seeking Balance

Surpluses and deficits reflect deeper choices about saving and investment across interconnected economies

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MORE THAN 80 years ago, John Maynard Keynes centered his work on the persistence of global imbalances. The great economist tried to resolve what he described as the "secular international problem" at the Bretton Woods conference in 1944 through an international clearinghouse. But the conference's final agreement included only a weaker set of remedies.

Concern about imbalances has waxed and waned in the decades since, but has returned to the forefront of the policy debate in recent years. Global imbalances widened again in 2025, reversing steady narrowing during the decade after the global financial crisis and reviving difficult questions about their sustainability.

Keynes's point was simple but profound: In a world of interconnected economies, countries cannot save, spend, or borrow independently. Imagine a small neighborhood. One household saves almost everything it earns. Another spends more than it earns and borrows to make up the difference. For a time, the arrangement works. The thrifty household finds a reliable borrower and earns a return while the spendthrift household enjoys a comfortable lifestyle. But as debts accumulate and positions become entrenched, what began as a mutually convenient arrangement can become fragile and fuel tensions.

Global imbalances are this story's international version and refer to the pattern of surpluses and deficits across countries. Every country keeps a ledger with the rest of the world, called the *current account*. This records the value of the goods and services it sells and buys abroad as well as income flows associated with foreign transactions. When a country sells more than it buys, it runs a *surplus* and lends to the rest of the world. When it buys more than it sells, it has to borrow from other countries and run a *deficit*.

Saving and investment

At its core, a current account balance reflects a simple idea: the difference between what a country saves and what it spends. This is more than a simple accounting identity; it reflects the complex forward-looking choices of economic agents. For instance, households consume and firms invest when they expect higher income in the future or face temporary shortfalls. They save when their income exceeds their desired consumption, when investment opportunities are limited, or when they worry the economy might weaken and want to put money aside.

Exchange rates play a role, too, but it is often misunderstood. A country's currency tends to rise or fall to keep trade broadly in line with the saving and investment balance. Exchange rates, in other words, tend to reflect current account positions rather than drive them.

Seen this way, global imbalances are not primarily about trade competitiveness. They reflect structural differences in the pattern of domestic saving and investment across countries—driven, for example, by demographics, growth prospects, financial development, and policy frameworks.

The recent increase in imbalances reflects mostly developments in the world's two largest economies. A slump in China's property market five years ago depressed domestic investment as construction of new homes stalled; households responded by slashing spending and saving more. In the United States, meanwhile, the government's large fiscal deficit—coupled with robust consumer spending—has depleted national savings.

DALE CROSBY-CLOSE

Cause for concern

Not all deficits or surpluses are a problem. They can be a natural and even desirable outcome of efficient resource allocation, if capital flows to younger fast-growing developing economies from aging advanced economies, for example. The concern arises when imbalances become excessive and are rooted in persistent distortions that pose serious risks to global economic and financial stability.

The longer deficit countries rely on external borrowing, the more vulnerable it leaves them to sharp changes in global financial conditions. If investors lose confidence or financing becomes more expensive, capital inflows can reverse suddenly. The result is often currency depreciation, financial stress, and economic recession, as occurred in Mexico in the early 1990s and East Asia later that decade.

Surplus countries do not face the same risks of correction, but their policies can have consequences for other countries that build gradually over time. When surpluses reflect weak domestic demand, underdeveloped financial systems, or policies that encourage saving, it may indicate that a country is using its resources inefficiently. Excess savings from surplus countries channeled abroad put downward pressure on global interest rates and prices.

Where surpluses stem from policies intended to strengthen export competitiveness, the disinflationary effects of cheaper exports can help trading partners struggling with high inflation—but they weigh on partners already facing weak demand, or those whose industries compete head-to-head with those of the surplus economy, dragging down their economic growth.

Financial markets can punish countries that run persistent deficits and correct their imbalances—by driving down the value of their currencies and driving up their borrowing costs—but countries with persistent surpluses face no comparable disciplining market forces.

At the global level, imbalances can amplify financial cycles. Large capital flows fuel credit booms and inflate asset prices in deficit countries. Surplus countries accumulate large foreign asset positions that are sensitive to exchange rates and interest rates. These dynamics can make the system more fragile.

Action on both sides

Left unchecked, global imbalances can also fuel geopolitical tensions. Factory closures, job losses, and other dislocations in communities or industries exposed to surging imports can fuel the perception that the playing field is unfair, strengthening support for trade tariffs and other protectionist measures.

So how should the world manage persistent imbalances? Countries may be tempted to reach for unilateral trade protection as a shortcut to rebalancing. But higher tariffs and other trade barriers generally have weak and unreliable effects on external balances because they do little to alter the underlying saving and investment drivers. The protectionist measures can instead trigger tit-for-tat reactions that can further disrupt the global economy.

A more balanced outcome requires action on both sides. Adjustment is never a one-country story. After all, one country's deficit is another's surplus, and changes in one economy's saving and investment patterns affect outcomes elsewhere.

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Deficit countries need to strengthen saving and ensure that borrowing supports productive investment. Surplus countries need to boost domestic demand or reduce excess saving. When these adjustments take place together, imbalances can narrow in a way that supports global growth.

A balanced approach like this would facilitate orderly adjustment: Saving and investment shift gradually, supported by policy changes and stable financial conditions; exchange rates adjust; domestic demand rebalances; and external gaps narrow without major disruption. In fact, policy-led reforms to fix domestic distortions could yield a double dividend, boosting growth at home and curbing imbalances abroad.

The alternative is disorderly adjustment, driven by sudden shifts in market sentiment or financial conditions. A reversal of capital flows would force a rapid correction of deficits, a sharp contraction in output, and potentially a serious financial crisis with a material loss of global output.

Everyday decisions

Global imbalances are not the result of mysterious forces. They are an outcome of everyday economic decisions—how much to save, how much to invest, and how to plan for the future. They reflect the fact that countries, like households, do not always spend exactly what they earn.

At their best, imbalances allow countries to share risk, smooth consumption, and allocate capital efficiently across borders. At their worst, they reflect domestic distortions, create vulnerabilities, and risk a costly reckoning. The thrifty household and the borrowing neighbor will eventually have to renegotiate their arrangement. The question is whether they can do so without creating a crisis that neither wanted.

That is the enduring challenge at the heart of the global economy—and the reason Keynes's "secular international problem" remains with us today. F&D

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