Our trade balance, the difference between the value of the goods and services we export and those we import, was a $760 billion deficit in 2006. This was the largest ever, about 6 percent of our annual GDP, or $2,500 for every person in the country.

What caused this trade deficit? Some point to China, where the government buys large amounts of U.S. securities with Chinese savings. Others point to protectionism by other countries. Still others suggest that U.S. producers lack competitiveness, or that the U.S. dollar is overvalued. However, these are only symptoms of the true cause.

The fundamental problem is that most Americans have stopped saving. Also, the federal government has been borrowing to finance its own budget deficits. Since our producers are still purchasing investment goods, where does the money come from?

The answer is that it comes from our trade deficits. Every dollar we pay to foreigners for our imports must return in one way or another. If foreigners don’t spend those dollars buying our goods, then they lend them back to us. When we buy more than we produce, we finance our purchases by borrowing from other countries.

Why do we consume so much? Easy access to credit helps. Other countries willing to save keep our interest rates relatively low, enabling us to spend beyond our production. Successive speculative bubbles in the stock market and the housing market led Americans to feel wealthier. We spent accordingly, expecting housing prices or share prices to keep rising. This created a self-fulfilling prophecy. Asset prices rose because we expected them to, as we bid up the prices.

The trade deficit is the annual increment of our international borrowing, a debt we eventually have to repay. Such deficits would be less of a problem if we were borrowing to finance investments in productive capacity rather than to finance consumption or real estate speculation.

Our large trade deficit is not sustainable, but how can we lower it? The current recession is starting to force a solution. In the first four months of 2009, our trade deficit fell to half of what it was two years ago, as imports have fallen dramatically. Unfortunately, investment spending is down much more than consumption spending, which is normal in a recession but not good for future growth. Until the crisis became international, the U.S. dollar had been falling in value, making our exports cheaper. But, now that our trading partners have also gone into recession, they will buy fewer of our goods, not more.

In the long run, we must achieve a more sustainable economy, one in which we do not spend more than we produce, we export more and import less, and we do not rely on foreign savings to cover our excess outlays. Such an economy will be different from what we have experienced recently. It may be a difficult adjustment for us and for the rest of the world, which has depended on our spending to drive its growth.

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