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2 MR. KREGEL: Thank you very much, Mr. Chairman,
3 members of the Commission. My remarks are divided into three
4 sections. The first section is a general section that warns the
5 members of the Commission that looking at either any one
6 particular aspect of the overall U.S. balance of payments position
7 may be deceptive, basically because balance of payments are
8 accounting items. By accounting items, we arrange those balance
9 sheets so that they always balance. The problem is to discover
10 just exactly which items change, which items are considered as
11 autonomous items, and which items are affected by those autonomous
12 items.

13 The balance of payments can be divided into the
14 trade account, current account, and the capital account. We could
15 just as easily say that the United States is suffering from a
16 capital account surplus as it is suffering from a current account
17 deficit. These are two statements which mean precisely the same
18 thing. We can only give meaning to these statements by trying to
19 understand whether or not it is the capital account which is
20 driving our current account position or vice versa.

21 In a global economy, the inter-dependence of
22 international trade suggests that any decision which is taken by

1 any individual country will depend on like decisions that are
2 taken in other countries. I'm sure you will all remember the
3 1960s, in which the United States attempted to solve a current
4 account deficit position and ran into extreme difficulties because
5 of the unwillingness of a number of international partners to take
6 steps which we thought were appropriate to allow the United States
7 to adjust.

8 So that the first section is to suggest that it is
9 inappropriate to look only the behavior of agents within the
10 United States economy when assessing the trade deficit. We must
11 look at the U.S. position in an international context and in the
12 behavior of the global economy.

13 The second section then deals with the current
14 global position. I am sure you are all aware of the Asian crisis
15 and aware of the changes that have taken place in international
16 competitiveness, in exchange rates, and international trade flows.

17 The second section looks at the current behavior of the U.S.
18 balance of payments as a response to the changes that have taken
19 place as a result of the Asian crisis. It looks at the behavior
20 of imports and exports in the United States economy.

21 If you look at the drafts and charts that are
22 appended to the paper that I have prepared, they are divided into

1 roughly three sections. The first section shows the current
2 balance of payments, and suggests that the current balance of
3 payments on a historical level is not exceedingly large, but is in
4 fact as large as the largest current account deficit as a percent
5 of GDP in recent history. That is, the period in the early 1980s.

6 It also suggests that we can look at the balance of
7 trade in manufactured goods, which is usually considered to be one
8 of the most important aspects in influencing income and employment
9 in the economy, as a proxy for the current account since it tends
10 to track it relatively closely.

11 If we look at the behavior of imports in goods and
12 services, we can divide imports of goods and services into changes
13 in volume, that is, the amount of physical goods and services that
14 are imported into the economy, and the value. That is, how much
15 we pay for those goods and services. You will note that the
16 volume has increased dramatically relative to the value.

17 Now the increase in volume over recent history
18 represents some significant changes. If you look at the behavior
19 over the 1960s through to the 1990s, you will note that imports
20 have two relative plateaus. That is, they seem to remain stable
21 and then adjust. These plateaus, I would suggest, are the result
22 of the fact that the U.S. economy has tended to go through

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1 cyclical periods in which expansions and contractions have roughly
2 balanced off in their impact on imports.

3 However, since 1992, the current expansion, as you
4 know, has been the longest and most sustained in recent history.
5 This has produced the longest and most sustained increase in
6 import volumes. So I would suggest that the changes in import
7 volumes in the United States have in fact been due to the
8 sustained increase in GDP within the United States at rates which
9 have currently run between three and four percent. So this is
10 purely due to internal factors.

11 If we now look at exports of goods and services,
12 you will note that exports of goods and services in both volume
13 and value have declined substantially after 1997. This is in fact
14 in response to the Asian crisis in which the demand for U.S.
15 exports by the Asian countries, and by a knock-on effect to most
16 Latin American countries, has declined. So that we could say that
17 in terms of the impact on the overall current account, in looking
18 at the value shares, the decline in exports has been the main
19 cause of the increase in the U.S. deficit. This is what we should
20 expect as a result of the Asian crisis.

21 On the other hand, the impact on the U.S. economy,
22 as we know, has not been extremely detrimental. This we see by

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1 looking at the changes in the volume shares, which are often
2 represented by changes in the terms of trade. In fact, as a
3 result of the decline in the prices of imports that we pay in the
4 United States, the United States has a sharp increase in terms of
5 its purchasing power over foreign goods. This has meant that the
6 trade deficit has not increased in value terms by as much as it
7 would have done had the price adjustments not taken place.

8 So that if we look at the behavior of the current
9 trade deficit, we can look at it as part of a normal adjustment
10 process in terms of volumes. That is, an increase in imports and
11 a decline in exports. The increase in imports due to the
12 expansion in the United States, the decline in exports due to the
13 decline in demand from the Asian countries, which is what we
14 should have expected from the adjustment to Asia. The benign
15 impact on the United States economy is due to the terms of trade
16 effect in which we pay less for imports relative to exports, which
17 has increased income and kept the deficit down relative to what it
18 might have been if the adjustment had taken place at constant
19 prices. Thank you.

20 CHAIRMAN WEIDENBAUM: Thank you, Professor Kregel.

21 Our third presenter is Dr. Catherine Mann of the
22 Institute for International Economics, and author of a book about

1 to be published, likely the definitive book on the subject of the
2 trade deficit. I'm pleased to at this point acknowledge Dr. Mann.