MS. BATES: Thank you very much. I’d like to thank the Commission for the opportunity to testify here today. I’ll do my best to stick within the traffic regulations.

I’d like to touch briefly on the definition and then measurement of the deficit, because I do think this has some bearing on the debate about the causes of the deficit. And then turn at the end to look briefly at the causes.

In reference to the definition, I think my main point would be that in much of the popular debate surrounding the trade deficit, many people refer to the merchandise or goods trade deficit, but as the U.S. is a significant and persistent net exporter of services, looking at the merchandise trade deficit significantly overstates the deficit of the U.S. So, that would just be a point to be aware of when looking at this figure. I think there’s often a problem with definition of the term.

Turning to the measurement, I would argue that one important but often overlooked cause of the U.S. trade deficit, or at least partial cause of the U.S. trade deficit, is indeed statistical error. Now, clearly mismeasurement of U.S. trade is only relevant for the deficit figure, if the error is significant, persistent, and biased in terms of exports and imports, thereby having an impact on the deficit.

It seems that in practice, most of these criteria are met. According to a Census Bureau study, U.S. goods exports are persistently undercounted by three to ten percent. The same study noted that there was no evidence of significant errors in the import data, and it didn't look at services, so we're just looking at the goods side here.

Applying this approximation to the 1998 deficit on goods and services would reduce that deficit from $164 billion to $97 billion, or by about one-third. So, it's a significant understatement of exports.

The study goes on to look at the causes of this, and one of the primary causes is the fact that exporters are not required to report exports valued under $2,500. Instead, the Census Bureau uses estimates for those based on historical data. Indeed, new data for exports under $1,000 have not been collected for over a decade.

Now, given that there's been an increase in just-in-time inventory practices, increased flows of interfirm trade over the borders with Canada and Mexico, and increase in small business trade, these small value exports have increased quite significantly over time, and are therefore being underestimated in the current data.

I would argue that it's likely that mismeasurement is going to increase in future with new activities, such as E-Commerce.

So, the point I'd like to make here today is that a significant contribution to the debate surrounding the trade deficit could in fact be made by improving data collection and dissemination.

Turning now briefly to the causes of the U.S. trade deficit, I would agree with my colleague, who outlined I think quite clearly just now, that the fundamental factor underlying both the strong U.S. dollar and the U.S. trade deficit is the relative strength of the U.S. economy compared to those in the rest of the world.

That is clearly the strong domestic demand is for all products, including imports coming into the U.S., and, similarly, the strength of the U.S. economy as a place to invest.

This is encouraging inflows of capital, particularly portfolio investment and particularly from the UK, which is interesting from my point of view, being my home country.

This inflow of capital is fueling the stock market boom, which is increasing household net wealth in the U.S. and encouraging even further imports. Obviously, the inflow is adding to the appreciation of the dollar, making imports cheaper.

So, I think the central point to realize here, as outlined earlier, is that as the Asian and, perhaps, more importantly, the European economies begin to recover and pull out of recession, it seems likely that this capital inflow will at least decline, if not, reverse. That will then have a depreciating effect on the dollar, thereby making exports cheaper and imports more expensive to the U.S. and reducing the trade deficit.

I think the issue that is on a lot of people's minds at the moment is how exactly this readjustment is going to occur, whether it will occur slowly over a period of months and years or whether there will be a more sudden reversal of the flows and more of a shock to the economy. And that's notoriously difficult to predict, and I don't really want to get into doing that.

So, just to conclude, I'd like to make three points. First of all, it's important to use an accurate measure of the trade deficit when talking about this, and I think that's part of the problem with this debate, a misunderstanding of the figures themselves.

Secondly, that the current trade deficit is significantly overstated and that there are going to be important measurement problems in future. We need information age trade statistics, if we're going to have an informed debate about the economy that the U.S. is currently exhibiting.

And, thirdly, that the main macroeconomic cause of the trade deficit is the relative strength of the U.S. economy. Ironically, as other economies around the world begin to recover, that could mean a readjustment for the U.S., too.

Thank you.

VICE CHAIRMAN PAPADIMITRIOU: Thank you very much.

The next panelist is Mr. Daniel Griswold from the Cato Institute who is the Associate Director of the Institute's Center for Trade Policy.

Mr. Griswold.