Chapter 2

Causes of the U.S. trade and current account deficits

Two Differing Views on the Causes of the Trade Deficits

Democratic and Republican Commissioners hold differing views on the causes of the trade and current account deficits. Their respective views differ over the importance of foreign trade barriers, and how to interpret the macroeconomics circumstances surrounding the deficits, including the role of international capital flows.

In the view of the Republican Commissioners (page 19), U.S. and foreign macroeconomic performance primarily cause trade and current account deficits. In the 1990s, the relative strength of the U.S. economy led to substantially increased imports, while the relative weakness of many of our trading partners led to much slower growth in exports. The long-standing tendency for U.S. imports to grow faster than U.S. income adds to this faster growth in imports compared to exports. Trade barriers are objectionable, but not because they are a major cause of trade deficits.

International capital flows, in their view, are also a consequence of the relative strength of the U.S. economy. With a higher rate of return on investments here than in other countries, the United States is an attractive target for investment. This brings substantial benefits to the United States. In particular, since total saving in the United States is less than total investment, capital inflows help to finance investment that otherwise could not occur. Furthermore, the large net capital inflows have been keeping the dollar stronger than it would be otherwise. The strong dollar makes U.S. exports less price competitive and U.S. imports more attractive, contributing to the trade deficit.

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In the view of the Democratic Commissioners (page 41), the U.S.' large and growing trade and current account deficits are caused by a number of long- and short-term factors.

Key long-term factors include:

- Unequal relationships with America's major trading partners. The U.S. market is more open to imports than any other country in the world. High nontariff barriers to trade in foreign markets are an important cause of this problem. These include quotas, private trading arrangements (such as the Japanese keiretsu groups) and other restrictions that reduce U.S. exports (i.e., restricted access to foreign exchange) to China and many other countries.
- Predatory practices, such as dumping, that have increased U.S. imports.
- Foreign government subsidies to foreign companies for research, development, and production that have not been effectively challenged or countered by the U.S. government.
- Multinational corporations driving globalization. U.S. firms have been world leaders in eliminating jobs at home and moving production technology and production offshore.
- The loss of competitiveness of U.S. firms on the one hand, with developing countries that depress workers' rights, environmental standards, and workers' wages so as to lower costs and unfairly compete for larger shares of the U.S. market, and, on the other hand, with those from Europe and Japan because they often have higher levels of productivity growth than the United States.
- The failure of other nations, especially in developing countries, to enforce their labor and environmental laws and observe internationally recognized labor standards.
- Low rates of saving in the United States, which have also contributed to trade and current account problems.

Short-term factors have also contributed to the recent growth of the trade deficit. These include: (1) higher oil prices, (2) the 23 percent increase in the value of the dollar since 1995 that has made imports cheaper and the price of our exports more expensive to foreign buyers, and (3) slow economic growth in other countries.

We also found that the U.S. manufacturing sector accounts for most of our trade deficit. Manufacturing industries will have to expand significantly if the United States is going to respond effectively to trade deficits and globalization. To do this, the United States will need new trade and development policies that will help rebuild manufacturing and reduce unfair barriers to trade around the world. We also need new tools to encourage U.S. multinationals to maintain jobs, technology, and production here in the United States.