The U.S.Trade Deficit:

A View from Europe

An Evaluation for the
Trade Deficit Review Commission of the U.S. Congress

Part I: Analysis

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Introduction

What is the quantitative dimension of the U.S. trade deficit?
What is the development of its subsets?
What is the nature of the deficit?
What are the main factors causing the deficit?
Is the U.S. trade deficit tolerable much longer?

These are the main questions to be answered. The answers concern not only American interest; they are equaly important for other major areas of the world - for instance for Europe.

For a long time the trade deficit has not been in the foreground of American public opinion. Public opinion focused rather on the positive aspects of middle-term performance of the American Economy.

Without any doubt positive aspects do exist. The American Economy has been in very good shape for a long time:
High growth rates, low inflation, full emloyment, excellent state of federal finances, high flying stock prices – this was the combination, which Alan Greenspan has labeled: „phenomenal performance“.

This exclusive concentration on middle-term business cycle performance, however, was misleading. Why? Taking a broader view and investigating the long-term and structural development shows a completely different picture of the economic development. We have to search for the causal factors of the trade deficit in areas other than the cyclical dimension.

The set of 16 data charts used in this paper is organized in the following way:

- the paper presents mostly *long-term data* over a range of four to five decades;
- the data is taken from the *top of the macro information pyramid*. This is basic data of the economic pattern;
- the data are aimed at clarifying mainly the link between *real business performance* and the trade deficit. Some links to financial markets are included as well. We will also mainly stick to the macroeconomic level and will not go deeply into subsets, like the service sector for instance.
- The charts do not form a strictly causally connected chain. This is a series of charts containing ex post data. We do not intend to derive simple ex ante conclusions from them. We will, however, make some plausible remarks about the connections between them. Plausibility in this case is understood in that all of the presented charts support each other. And they all point in the same direction: It is not possible to maintain the US trade deficit at this level for much longer.

This chain looks like the following:

(I) Main Macro Factors Causing the Trade Deficit

1. Propensities to consume and to save (*Charts 1 to 3*)

The propensity to consume is the starting point of the analysis. Statistics show that in the USA the consumption ratio has been relatively high for decades.
The trend is increasing. The share of consumption of GDP rose by 6.1 percentage points from 1961 – 99.

In Europe this consumption ratio remained on a level of about 61 % over this period.

The difference of these two ratios (7.3 % in 1999) is substantial. This has consequences. It reduces possible spending for other final uses; the higher the consumption share the lower the remainder for other final uses of GDP, among them investment.

The flip side of the consumption ratio is the ratio of saving.

The US ratio of *personal saving* shows a sharp decline over a long period (*Chart 2*). In 1998 the Americans saved only 0.5 % of their disposable income (after tax). In 1999 this ratio even became negative, which means that there was a form of dissaving. In August of 2000 an all time low of -0.4 % was reached. The Americans are far less willing to save compared to the Europeans.

The ratio of saving in the *private sector* (saving as % of GDP) (*Chart 3*) also fell dramatically in the USA, by over 6 percentage points from the 70s to the end of the 90s. In contrast to this the European saving ratio remained at a high level.

Attempts have been made to deproblematize this propensity to save. The essence of the argument was to point out that the wealth of Americans has increased so greatly through high flying stocks, that the level of consumption could be financed easily. According to this argument the increase of the value of stocks would have to be calculated as income. This argumentation confused basic macro economic categories. It simply ignored the fact that wealth is a stock category, while income is a flow category.

Aside from this, American politics has set different priorities in relation to this phenomenon. That is to say, because of this problem President Clinton organized a „Savings summit“ in June 1998. Leading representatives of the Republican party (Gingrich, Lott) participated in this conference to emphasize a broad political basis regarding this question. Vice President Al Gore perceived this challenge as a „national priority“.

The differences in saving between the two world areas are huge (1998 = 7.5 percentage points) and have consequences.

2. Ratio of Investment (*Chart 4*)

The consequences of these very different ratios of consumption and of saving are reflected in the shares of investment. As all ratios add up to 100 %, high consumption ratios cut down the possibilities for the rest of the remaining ratios, that is (Investment) + (Government expenditures) + (Exports - Imports). Since consumption is a big weight in these 4 components of GDP it is likely that it has an effect on investment.

In spite of the fact that the the US investment ratio did not fall over the last 40 years it is still on a relatively low level (with 16,1 % in 1998).
The European investment ratio has somewhat declined but still exceeds the US ratio significantly, and this has been true for four decades (note a difference of 10 percentage points in 1970!).

The importance of these differences in percentage points can be demonstrated in absolute figures. To give an example: If the USA had had the same investment ratio as Europe, it could have invested about 200 billion $ more in 1998 than it actually did.

At this point it should be stressed that in this connection we are not speaking of historical events. These differences result in long lasting effects. The USA had a clear lead in accumulated wealth at the end of World War II. The stock of capital, however, has to be depreciated - year by year. Only investment exceeding this depreciation, which equals net investment (or net saving), results in a growth of capital in the economy. The substantial differences in investment shares in both areas over such a long period have led to a conspicuously different growth of capital formation.

If the US invests so much less in plants, tool machines, machinery, human resources (qualification) year by year, then you can expect, that this will have consequences for productivity.

3. Growth and Level of Productivity (*Charts 5 and 6*)

If a country realizes a lower investment ratio over decades, this is going to result in lower growth of productivity.

A main part of this investment volume is invested in productive purposes: expansion of manufacturing facilities, modernization of production technologies, construction of new plants for production purposes, etc. These investments will always lead to improved qualitative and technical levels. Seldom do you just replace old technology, mostly you replace it with the latest and newest technology.

Thus, investment in the enlargement of capacities and expansion of production, but also in the mere replacement of older technology always results in increases in productivity. This is especially true for investment in rationalization, where the explicit purpose is to increase productivity. Higher capital intensity and better capital quality leads to an increase of labor productivity. The empirical data demonstrate this[i]: European *growth* of productivity has exceeded American growth over the whole period – between 1974 to 85 by four times, and in the nineties by nearly two times.

Therefore as we would expect, the noticed differences have results in economic performance. We have to be aware that these gaps exist over a very long time.

A result of the substantially higher consumption ratio and lower investment ratio therefore is a productivity gap. The empirical data for the level of productivity prove this clearly:

Consequently the higher growth of productivity in EU led to a faster rising European *level* of productivity, which is measured as GDP per hours worked. For instance the German level was 52 % of the US level in 1960; in 1997 it exceeded the US level by a little bit, although the low figures of East Germany had to be included after the re-unification with West Germany.

A new study[ii] demonstrates a surprising lead of the Europeans. The published table in this study shows a US level of productivity of 120 %, Germany 106 %, an average for OECD of 100 %. This result, however, is not correct.

The authors used „GDP per hour“ as the measure of producitivity.

The *output* was calculated on the basis of OECD estimates for PPPs (1993) according to EKS. Hence, GDP of 1997 was expressed in prices of 1993 and then transformed into US $ on the basis of 1993 EKS PPPs (while the Maddison concept is based on Geary-Khamis).

The deciding factor for the final result, however, is the *input* , i.e. in this study the selected amount of worked hours per country.

For the USA two possibilities were discussed.
First: estimates according to Maddison, which allow 1628 hours per year and per employee (1997).
Second: estimates according to OECD, which on the other hand allow 1966 hours for the USA.
Van Ark/McGuckin then rejected the OECD estimate and selected the Maddison estimate for „reasons of plausibility“ (without providing any deeper justification).
And of course, this selection is decisive for the final result, regarding the big difference in the amount of labor volume.

However, there cannot be any doubt that the estimate of OECD is closer to the facts than Maddison. Just shortly after the publication of the Conference Board an investigation of ILO was released[iii]. Here the empirical findings for the USA show a working time of even 1996 hours per year. (Secretary of Labor, Alexis Herman, and President Bill Clinton argued in March 2000, that an increase in the minimum wage of one dollar will lead to an increase of income of $ 2000 per year; this calculation is implicitly also based on an estimate of 2000 worked hours per year).

Precisely reasons of plausibility should have required the application of the second method of The Conference Board. Van Ark/McGuckin showed the results for this estimate in their article, too (*chart 6*). Unfortunately not all of the EU countries are included. But the the results of the 9 countries shown are conclusive because these countries represent all the major economic weights in the EU. The first four countries show a lead of 20 to 30 % in comparison to the USA. The 5 following countries still exceed the US level by 1 to 9 % (the figures for Germany include the low figures for East Germany).

Higher consumption and lower investment leads to a gap in productivity.
This productivity gap has two major consequences:
The *first consequence* is to be seen on the labor markets of both areas (we include these effects in this paper in order to get the full picture).
The *second consequence* is the declining competitiveness of the U.S. economy (Chapter II).

4. Production, Productivity and Labor Volume (*Charts 7 and 8*)

Without any doubt the American labor market is in much better shape than the European one (*Chart 7*).
According to internationally comparable figures unemployment in the EU is more than double that in America.
The prevailing explanation for this performance is the strong growth of GDP. But this does not tell the full story.

In the United States the dominating picture identifies EU unemployment with an inefficient performance of the economy. The above shown data chain already reveals that this is a false conclusion.
In addition the basic determinants of labor volume lead to a different picture.

The EU has indeed a severe labor market problem.
This problem, however, has to be analysed properly in order to fully understand this phenomenon. This requires a long-term analysis. A long-term analysis specifically shows that an identification of labor problems with the performance of the economy is definitely wrong.

This judgement is based on the experience deriving from the Great Depression of the 30s. The mistake of taking the problems of the labor market as a hint for the general economic performance, has distorted the picture of the current European position (EuroSclerosis).
To draw a simple conclusion from the causes of the depression is truly inappropriate in the 90s:
In the 30s we experienced a *parallel* downward spiral between the economy and the labor market.
In the 90s we experience the contrary.

Chart 8 explains the differences between the EU and the USA in this field:

In the last cycle from 1991 – 1998:
total growth of GDP is positive in both countries; in the US, however, it exceeds the EU by a factor of two (24.2 % compared to 11.7 %).;
On the other hand European productivity exceeds that in the USA considerably (20 % compared to 7.7 %);
Because EU productivity exceeded EU production by 8.3 percentage points it needed 7 percent fewer employees to carry out that production.

In the USA the contrary was true. Because in the US productivity was conspicuously lagging behind production (16.5 percentage points), an additional 15.5 % workers had to be hired to carry out this production. This lag in productivity basically explains the outstanding performance of the American labor market.

This data clearly proves that it is by no means correct to explain the existing problem of unemployment in Europe by relating it to the causes, which prevailed in the crisis of the 1930s.
In the case of EU we now have to realize two things.
On the one hand, economic conditions are in good shape – EU has got growth and competitive strength; the balance of trade shows a sufficient EU position on global markets. On the other hand, the total amount of labor volume is shrinking despite the good overall economic conditions – unemployment is rising.

This discrepancy between a *growing* economy and a *declining* labor market can be explained by the causal factor of productivity – at least in the EU.
Alan Greenspan proclaimed in 1997[iv] a „revolution in productivity" for the USA, which one had not seen since the beginning of the century. So far it has been difficult to find substantiation for this claim in the long-term macro statistics of the USA.
But for Europe it is definitely true. Here we have got a revolution in productivity. This is already visible mainly in the micro statistics, on the shop floors, in the companies, in the corporations[v]. In the 1990s this is also reflected in the macro statistics, as we have seen in the charts.

In order to prevent any misinterpretation: This is an empirical analysis – this is not a plea against productivity. We have to distinguish between *static* ex post results in productivity and between *dynamic* ex ante effects. The static ones have been presented in *Chart 8*. The importance of the dynamic ones come alive when comparing both countries.
A main question is, how to achieve a balanced integration of both dimensions.

In a recent discussion an American economist put it into this formula: „You have got productivity and we have got employment – you want employment and we want productivity“.

(II) The Problem of the Rising Trade Deficit

1. Balance of Trade and Balance of Current Account (*Charts 9 to 16*)

The significantly different figures concerning consumption, investment and productivity lead us to the expectation, that there must be a link to the question of competitiveness. Of course, productivity is only one of the many causal factors of the trade balance; but it is a very important one. The significance of this factor is not just revealed in a *static context* (productivity as a fraction, where the numerator (output) is divided by a denominator (input)). The significance of this factor, however, is mainly derived in a *dynamic context* (productivity over time is a result of qualification, creativity, innovation; output is not understood merely as a volume, but simultaneously as a quality). The dynamic concept shows direct links to competitiveness.

(a) The *second consequence* of the conspicuously lower investment ratio and growth of productivity is a lack of competitiveness.
The presented chain: high consumption → low savings → lower investment → lower productivity has a further negative consequence for a decisive sphere, namely the performance in foreign trade. Lower investment and insufficient productivity lead to a lower and eventually declining competitiveness of the US economy. In this connection we understand competitiveness as follows. The extent to which a country can be said to be competitive depends on measuring both its ability to export on one hand and its dependence on imports on the other hand; the balance comprises both effects. The final benchmark for competitiveness therefore is shown in the balance of trade and finally in the balance on current account.

In comparison to Europe the U.S. trade balance shows alarming results. In absolute terms a gap is opening between the trade balances of both areas (EU $ 99.4 billion export surplus, USA $ -347.2 billion export deficit in 1999; *Chart 7*). A similar pattern is to be seen in the balances of current account[vi]. (Early projections made for 2000 again present a large increase in export deficit in the USA).

(b) What is the nature of the U.S. trade balance – is it strucural or cyclical? In the last years the main stream explanation for this deficit has been strong performance of U.S. growth. In this account the unique expansion of U.S. GDP functions as a world business locomotive and attracts huge amounts of imported goods. Imports are mostly seen as cycle-related and as an indicator for a *strong* economy.

Just one single glance at the long-term development of the U.S. trade balance, however, proves that this explanation is insufficient (*Chart 10*). If we take the whole period since World War II into account we detect the full pattern. The dramatic overall picture for the USA can be seen in the long-term development. The American balance of trade up to 1970 always registered modest but at least positive export surpluses. The turning point then appeared in the first half of the seventies. Since then the balance has been permanently in negative territory - with an increasingly rapid decline. The shape of the curve is an additionally important fact: Optically it looks like an exponential trend

The USA has had a trade balance deficit for nearly 30 years, where as the business expansion first started in March 1991. At this point we therefore have to stress that the main pattern of the trade deficit is *structural* and not cyclical.

An investigation of the *subsets* of the trade balance adds further insight into its nature.

Chart 11 shows the distribution of export surpluses and deficits by principal end-use categories[vii]. Some export surplus is still in “Capital goods”, partially due to export of defense goods, which are included here. The main deficit sectors are just three: Industrial supplies and materials, Auto vehicles parts & engines and Consumer goods (excluding autos).
Chart 12 reveals the structural pattern of the development in these major manufacturing sectors. According to “monthly data seasonally adjusted” these categories have been in negative territory for nearly twenty years[viii]. (This is presumably the strongest indicator for the thesis of “deindustrialization” of the USA). The subsets also prove that the actual business cycle adds to the deficit, but that its nature is principally long-term and structural.

The structural deficit in the trade balance then transformes into a structural deficit in the balance of current account (C*hart 13*). The development of this deficit begins in the eighties. One reason for this time gap is that services functioned as a buffer. The development until recently shows an alarming trend downward, too. The balance of current account meanwhile has reached an all time high of more than 4 % of GDP. To fully judge this fact one has to realize, that this is about one quarter of the investment share of GDP!

(c) It is obvious that the cyclical factors add to the structural decline. The previously presented different charts proves this clearly. The trade balance for instance added another deficit of $ 100 billion just from 1998 to 1999, an increase of + 40 %. The balance of current account added even more, + 54 % in the same time span.
This is mainly a result of the high propensity of Americans to consume. And exactly this is another crucial fact. It makes a long lasting difference, whether the import surplus is used to finance additional investment or to finance consumption. This difference is also directly connected to the question of the tolerability of the deficit.

But we have to especially emphasize one phenomenon, that has been greatly contributing to the trade deficit for some years, i. e. the occurrence of the strong dollar. In the given situation and according to traditional economics one would have

expected a fall of the dollar to form a counterweight to the rising deficit. But the contrary is the case. Now we are registering tremendous imbalances - the world wide exchange rates have lost connection to the real structural data. The dollar has climbed to irrational heights, at least seen through the eyes of fundamental interests on *both* sides of the Atlantic (but other regions of the world, too).

Chart 12 has aready revealed that the deficit occurs exactly in those sectors of the economy where you find the jobs with high value added, in manufacturing. But the strategy of a policy of a strong Dollar has driven this devastating effect to an extreme..

Chart 14 shows the link between the depreciation of the EURO[ix] and the development of German export surpluses in trade with the USA. The Deutsche Mark reached its peak relative to the dollar in 1995, with DM 1.43 per dollar. September 21, 2000 an impressive DM 2.31 had to be paid for the same dollar, a depreciation of the Mark by nearly 40 %. German Export surplus in trade with the USA consequently rose nearly threefold in only three years - from DM 10.6 billion to DM 29.7 billion.

To give an illustrative example of these effects: Take the case of a middle sized German car, luxury class, which could sell for $ 30,000 on the US market.

In 1995 these $ 30,000 meant a turnover for the German auto maker of DM 42,900; and in September 2000 a turnover of DM 69,300.

First option for the auto maker is to let the price remain constant and then realize an increase of turnover of 60 %.

The second option would be to reduce his prices on the US market by nearly 40 % - and still take in the same turn over.

The projections for 2000 which are based on already existing figures indicate a further huge decline. One example: In the first 9 months of this year the following sales expansion rates on the US market were registered: Mercedes +10 %; BMW + 16 %; Volkswagen +17 %; Porsche in September + 42 %. In comparison: Ford +3 %; GM = stagnation; Chrysler –3 %.

Chart 15 on the other hand discloses the flip side of the coin. The development of exchange rates described above meant an appreciation of the Dollar relative to the DM(EURO) by nearly 40 %. The reaction to this upgrading was severe: American export deficits with West Europe increased from $ 15.2 billions to $ 48.3 billions, more than three times as much in four years.

To sum up these effects: Given the various factors which had already caused a structural deficit in the trade balance in the past, the additional policy of a strong dollar worked as an accelerator. It pushed the deficit to a new all time high.

2. The consequences of a negative Balance of Current Account (*Chart 16*)

As a rule one point of view is neglected in the analysis of the actual economic development. This point of view is an important qualitative criterion for the structural development. It is important to realize that these results in the balances are not merely *annual* data. These are long term trends. *Over time* these balances *add up* to overall macro economic results. The effect is the same as that in the balance sheets of corporations.

Surpluses or deficits in the trade balance (more precisely in the balance of Current Account) are an important basis for and indicator of a country's position in the global economy. The reason for this is:

A positive balance will increase the net assets of an economy, because it leads to an increase in the *net international investment position*[x].
In this case net saving does not equal just net investment (= formation of domestic assets), but there will be an additional formation of international assets, i.e. investment outside of the country.

Alternatively a negative balance will decrease the investment position of a country. A deficit in the balance of current account means dissaving and disinvestment, a loss in the net international investment position.
This aspect has to be quantified.

(a) Empirical development of the U.S. Net International Investment Position

The U.S. net international investment position reflects the balance of all assets, which Americans own in foreign countries, minus all assets, which foreigners own in the USA.
The U.S. assets comprise the ones in private as in governments hands, for instance direct investment, reserve position in the IMF, special drawing rights, currency and deposits, portfolio investments, gold reserves etc. We have to deduct the same cross entries of all foreigners, which are liabilities of the USA.

The net international investment position of the USA cut the x-axis in the middle of the eighties and entered negative territory, following the negative trade balance and the negative balance of current account (*Chart 16*).

In the seventies this position still remained in positive territory. But the rapidly increasing deficits in the balance of current account used up parts of the existing assets year by year. In 1985 the last positive position can be found, i.e. $ 57.4 billion. In 1986 the total assets saved up after World War II were consumed. The curve cut the X-axis in a downward direction. Beginning in this year the deficit in the balance of current account produced an accelerating negative international investment position. The debt position of the USA worsened dramatically. For 1999 the position reached a level of $ –1,083 billion[xi]. Projections[xii] suggest a negative international investment position of $ 3,8 billion at years end of 2005.

The overall picture in the balance has therefore changed in the following way:

Until the middle of the eighties (probably since WW II) the USA, aside from their domestic net assets, owned additional international assets.
In the middle of the eighties these international assets equaled zero.
Since then the only assets shown on the balance sheet are domestic assets. However, on the side of the liabilities, in addition to Americans we now find foreign owners.

(b) Consequences of a negative International Investment Position

Concerning the increasing debt burden of the USA, *two main effects* have to be recognized:

(b1) A *first positive effect* has to be identified: This is additional investment opportunities in an open economy. The Council of Economic Advisers has described this in the Economic Report of the President.[xiii]
„In an economy closed to foreign trade and capital, all domestic investment must be financed by domestic saving. One of the principal benefits of increasing globalization of trade and capital markets is that the ability to borrow and lend in foreign markets relaxes the need to balance national saving with national investment in every year. If attractive investment opportunities are available at home but *domestic saving* is *insufficient* to pursue them, *foreign investors can step in*; the resulting excess of investment over national saving is manifested in a current account deficit". This is a precise analysis.

But the Council continues: „This aspect of globalization has been a favorable development for the United States, because it has allowed the economy *recently* to invest in capital equipment at high rates despite the persistently low national saving rate. The high rates of investment in capital equipment *over the past few years* have been critical in preventing the kinds of production bottlenecks that have often led to rising inflation rates at comparable points in past *business cycles*" (italics by the author).

This evaluation by the Council connects the first effect to *short*- and *middle-term* dimensions. The statistics, however, present a different picture: Higher rates of investment were not only financed by foreign investors „recently and over the past few years“. As shown in *Chart 13* the United States has been relying on this source of capital for more or less two decades. Therefore, in the case of the USA, this effect is not business cycle related but structural. It is important to repeat at this point that the inflow of capital was mainly not used to finance investment but consumption. This makes an important difference in the qualitative structure of financing. We would therefore like to question the statement, that the first effect is „positive“.

(b2) *Negative effects* have to be recognized on the other side of this evaluation. We have to distinguish *two* aspects:
o *One aspect* concentrates on the price which has to be paid for this policy. The Council analysed this precisely: „But maintaining national investment above national saving over long periods *does come at a price*: growing indebtedness to foreign investors. In the long run, increased foreign indebtedness means that a portion of the *extra future output* generated by the extra investment will be needed *to pay a return to foreign lenders*“ [xiv].

This highlights the fact, that access to foreign capital is not for free. Every investor demands a return on his investment. It does not make any difference, whether he invests in domestic or international projects, whether he favors government bonds or risk capital. Every single contribution to financing total U.S. investment demands a price.
The negative international investment position of the USA therefore is a financial burden on future domestic national income[xv].

Already in 1999 the deficit in the balance of current account equaled a burden of 3.7 % of GDP (the highest level in the past was 3.4 % in 1987). Accordingly, the burden of interest payments to foreigners is increasing: The net flow of interest payments to foreign countries is projected[xvi] to be $ 166 billion in 2005.

This second effect therefore is connected to *long-term* dimensions.
This aspect can be stressed in an American-German comparison. Long-term demographic changes are going to challenge Social Securitiy Systems in both countries (which are principally pay as you go systems in both). Taking into consideration the substantial differences in the personal saving ratio (*Chart 2*) this problem will – ceteris paribus - hit the U.S. retirees much harder than the Germans. The additional long-term decrease in the U.S. net international investment position will add to this burden for American retirees.
The Council of Economic Advisers gave this warning: „In the light of the demands that will be placed on the economy over the next 30 or 40 years by the retirement of the baby-boom generation, and considering that countries that are currently lending to us face similar *demographic challenges*, there remains a strong argument that it would be better to finance our high investment rates more through higher national saving and less by borrowing abroad“[xvii].

o *Another aspect* of the negative side concentrates on the loss of economic power which is also a result of this policy. This part of the problem is quite often forgotten in the various analyses.
The aim of direct investments in foreign countries generally is to control these invested volumes by the investor directly. Bayer Leverkusen bought the American Bayer-Company, Gerneral Motors bought Opel, Daimler-Benz bought Chrysler, BMW opened a new factory in South Carolina, General Electric bought the German Compunet AG in order to manage these investments directly. The purpose is always to control capital investments directly in order to gain a better position in the global race. As a rule this global expansion of direct investing is connected with taking the most influential and best paid jobs at the top of the company pyramid and at other key positions (head of departments, Meister positions etc.) The more top jobs taken, the bigger the gain in economic strategic control. The rest of the jobs are not effected strategically.

Therefore the USA - because of their decreasing net international investment position – have been suffering a creeping erosion of economic power for two to three decades. This erosion first shows in the corporations. As the corporations are the base of the USA, it eventually will effect the superstructure.

3. Interim balance:

It is clear that there cannot be any judgement concerning the general performance of the US economy exclusively based on the trade balance. For this kind of general judgement, especially for an assessment of future trends, a lot of variables have to be taken into consideration. For the assessment of the prevailing trends in the past and for the existing level of competitiveness, however, the balance of trade (and even more precisely the balance of current account) is the top criterion on the benchmarking hierarchy.
As the balance sheet of a single corporation compresses millions of company micro proceedings, the trade balance of a country compresses millions of macro proceedings. It eventually reflects all determinants on the competitiveness of an economy. Whether it is income or working time, taxation or infrastructure, qualification, productivity or the capability to innovate – every determinant in the end influences the propensities to export and import. The performance of an economy is reflected in the balance of current account as if seen through a magnifying lens.

The presented data show a chain of development, where three chain links occur following on from one another:

Since the beginning of the seventies the trade balance has shown a negative and accelerating trend.
Since the eighties the balance of current account has been following the balance of trade.

In the middle of the eighties therefore the positive U.S. international investment position which was built after WW II was eliminated. The USA began to run into debts.
Since the middle of the nineties these debts have increased with accelerating speed.

Up until now we have considered facts and not opinions.
But how can we assess these data sets?

Performance in foreign markets is of special *strategic* importance. In the case of the USA we have to pay attention to risky developments in this respect. The chain of plausibly connected determinants, presented in this analysis, which showed a loss in competitiveness for the US economy, leaves its strategic marks in two ways:

First, the cumulating loss in the international investment position is a financial burden for the future; for instance, it is complicating the problems with Social Security – hence a loss of welfare.
Second, the loss of control of direct investment leads to a loss of economic leadership - an erosion of the global economic power of the United States.

At this point it should be stressed again, that these are structural long-term trends.

(III) Summary

(1) For the USA some few – but basic – data chains have been analysed and evaluated in comparison to European developments. In statistics there is *always* the question of methodical reliability. This is even more the case with the comparability of international data. All presented charts, however, point in the same direction; they support each other and allow overall plausible conclusions.

(2) The American Economy has been in very good shape for a long time: High growth rates, low inflation, full emloyment, excellent state of federal finances, high flying stock prices – this is the combination, which Alan Greenspan has labeled: „phenomenal performance".
The middle-term, cyclical development of the 90s seemingly supported this impression. This exclusive concentration on middle-term business cycle performance, however, was misleading. Why? We have to search for the causal factors of the trade deficit in very different fields, not only cyclical factors alone. Taking a broader view and investigating the long-term and structural development shows a completely different picture of the economic development.

(3) If we had to put it in a nutshell, we could summarize: The US-model is short term and domestically oriented. This can be detected in the following chain of macro data:
Higher consumption and lower investment is leading to a gap in productivity.
This productivity gap has two major consequences:
The first consequence is to be seen in the U.S. labor market; it leads to full employment in the USA.
The second consequence is an eventual decline in competitiveness of the U.S. economy generally and in particular of manufacturing.

(4) The empirical data show the following chain of development:
Since the *beginning of the seventies* the trade balance has shown a negative and accelerating trend.
Since the *eighties* the balance of current account has been following the balance of trade.
In the *middle of the eighties* therefore the positive U.S. international investment position which was built after WW II was eliminated. The USA began to run into debts.
Since the *middle of the nineties* these debts have increased with accelerating speed.

(5) A negative balance of current account over time leads to a negative international investment position. In the short run this is an advantage. In the long run it is a burden.
First: As every investor demands a return on investment, the international debts of the USA represent a long lasting financial burden on domestic national income. There would be a possibility of accepting this, if the USA used the international capital for financing domestic investment. But for decades the main part has been used to finance consumption.
Second: A negative balance of current account leads to an increasing ratio of foreign direct investment on U.S. territory. This leads to a loss of economic influence - firstly in the base, then in the superstructure. The USA have been confronted with a creeping erosion of economic power for two to three decades.
Both effects result in a higher standard of living at the present time, but a lacking growth of welfare in the long run and also a loss of economic leadership.

(6) We derived the main structural causes for the trade deficit from the macro structure.
Nobody overlooks the differences behind these macroeconomic averages. There is for instance the brilliant American standing in IT, in the computer field, in first class research, and in pop culture. How many other examples can we find?

On the other hand we should not overlook the micro structure. The dynamic concept of productivity was mentioned. But further research on its significance for the investigated problem has to be carried out.

(7) First of all the deficit in the trade balance is a structural phenomenon, but cyclical factors added to the decline. Given the various factors which already caused a structural deficit in the past, the addition of the policy of a strong dollar in the last years had an effect like an accelerator. It pushed the deficit to new all time highs. This has had devastating effects on the manufacturing sector (second round of de-industrialization) and all the jobs connected to it, while benefiting the financial sector of the U.S. economy (in Europe this is vice versa).

(8) The deficit in the trade balance and balance of current account is not tolerable. First, because of quantitative reasons: A deficit which equals about 25 % of the investment ratio is too heavy a burden over time.
Second, because of the shape of the deficit curve: The accelarating speed is not sustainable for very long.
Third, because of qualitative reasons: The burden is accepted for reasons of consumption rather than investment.

(9) At the moment the U.S. balance of current account is the most threatening balance sheet in the world. Major trends have moved too far away from underlying real structures. The risk of uncontrollable reactions is growing in relation to this deviation. That is the reason, why a turn around is not only in the interest of the USA. It is of global importance.

As the deficit is both structural and cyclical, a policy of a turn around has to concentrate on fundamental and short time factors.
The most difficult part will be the change of the fundamental factors causing the structural deficit.
The more easy part should be to change the policy of a strong Dollar.

[i] Wolfgang Gerstenberger: Wachstum ohne Jobs in Europa: Wo liegen die Ursachen? In: IfO-Schnelldienst, Nr. 7/1999.

[ii] Bart van Ark and Robert H. McGuckin: The Conference Board N.Y.; in: Monthly Labor Review; Bureau of Labor Statistics, July 1999

[iii] Lawrence Jeff Johnson, International Labor Organization, Geneva: Key Indicators of the Labor Market, September 1999

[iv] Business week, July 14, 1997, p. 45

[v] To give an example: Volkswagen built 1.25 million cars in 1991 with a total labor amount of 205 millions hours; the same volume of production will be manufactured in 2001 with only 100 million hours (member of the Executive board Peter Hartz). This equals an increase of productivity of 105% (!) over the whole range of a big corporation

[vi] The absolute differences in the balance of current account are not fully comparable (according to a methodic footnote of the European Central Bank which does not publish external data in this case)

[vii] These data comprise nearly the full trade balance, just missing the neglectable category “others”. Trade in goods, census basis by end-user category; Council of Economic Advisers, Ec. Report of the President; Bureau of Economic Analysis

[viii] Quarterly data seasonally adjusted, which are not directly comparable with monthly data, even show red figures since the middle of the sixties for “Automotive” and “Consumer goods”

[ix] Note: The EURO is economically in existence since Jan 1, 1999. Chart 12 uses DM/$ as indicator for the development of the EURO (right scale). For 1995 to 1998 this could be tolerated because Germany is the biggest economic weigth in EURO area. Beginning 1999 DM/$ reflects identical changes to EURO/$

[x] This is not the case with entries within the capital balance. If a European company for instance takes out a loan in U.S. dollars to buy a U.S. company, then we will find this loan as a cross entry to that investment. The net international investment position of Europe as well as that of the USA is not going to change by this operation

[xi] Bureau of Economic Analysis; calculated „at current cost“, i.e. assets of companies are calculated with cost for replacement investments of physical installations; all mere changes in values at the stock exchange are eliminated (these are calculated in the concept of „market value“, which already in 1998 shows a net international investment position for the USA of $ -1,537.5 billion. We made a decision in favor of the concept of „current cost“, in order to be cautios. But taken into account that we obviously face a long-term asset inflation it well could be argued that the „market value“-concept would be more appropriate

[xii] Robert A. Blecker, American University, Washington DC.: US balance of payments shows record red ink, EPI-Trade fax, March 2000

[xiii] Council of Economic Advisers, Economic Report of the President, Washington, Febr. 1998; pages 77-78

[xiv] Economic Report 1998, page 77 – 78

[xv] „While this massive international borrowing helps to finance US economic growth in the short term, it also undermines the sustainability of that growth in the long run“, Robert A. Blecker, American University

[xvi] Robert A. Blecker, EPI Trade-Fax, March 2000

[xvii] Economic Report of the President 1998, page 78

The U.S.Trade Deficit

A view from Europe

An Evaluation
for the Trade Deficit Review Commission of the U.S. Congress

Part II: Empirical Appendix - A Set of 16 Charts

CenterAgendaConsulting
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Frankfurt/Germany and Washington D.C., October 2000
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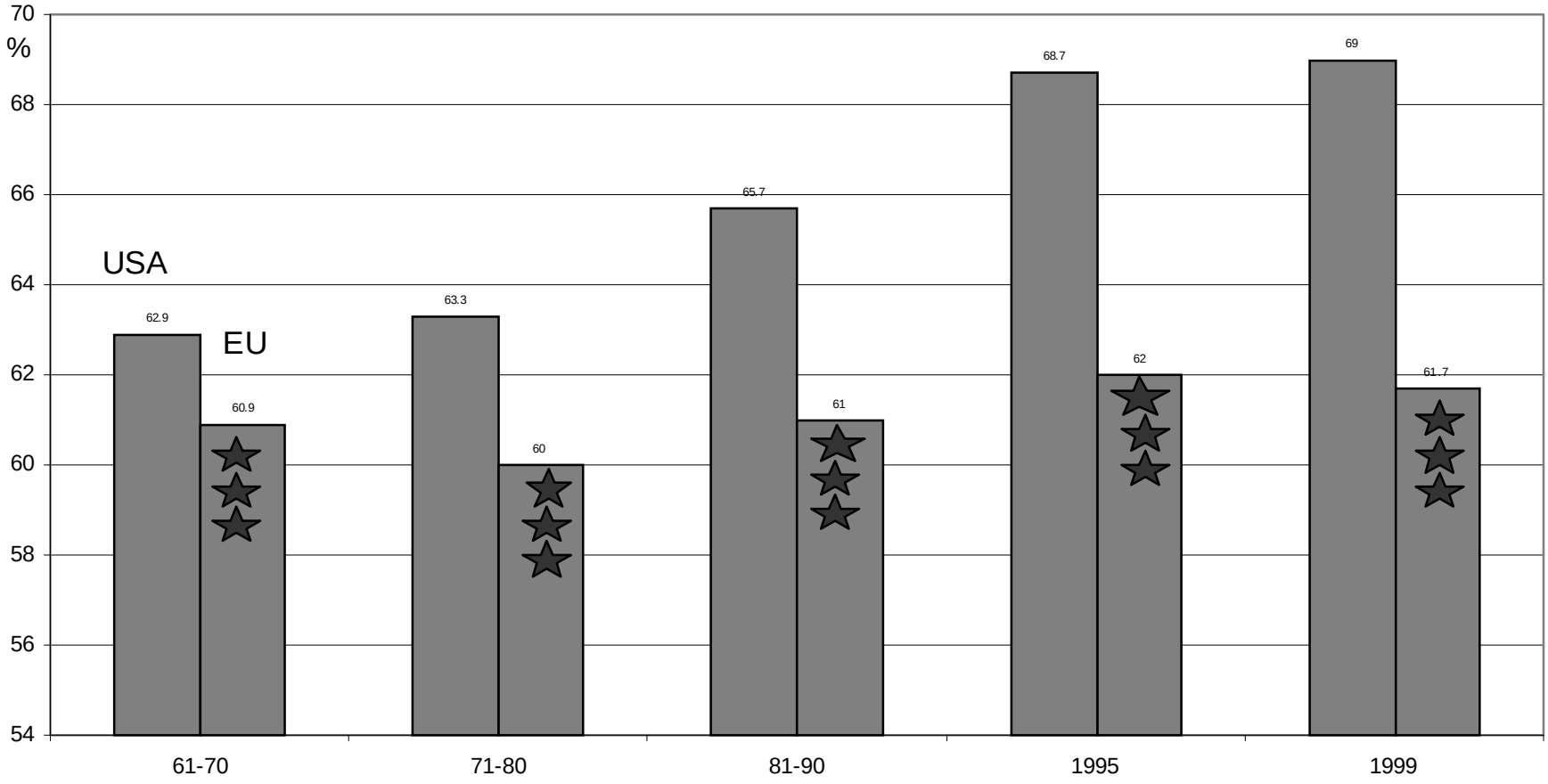
Chart 1: US Consumption substantially higher



Source: EU Commission (DG Econ+Fin); (priv. C at current prices as % of GDP); EU-15

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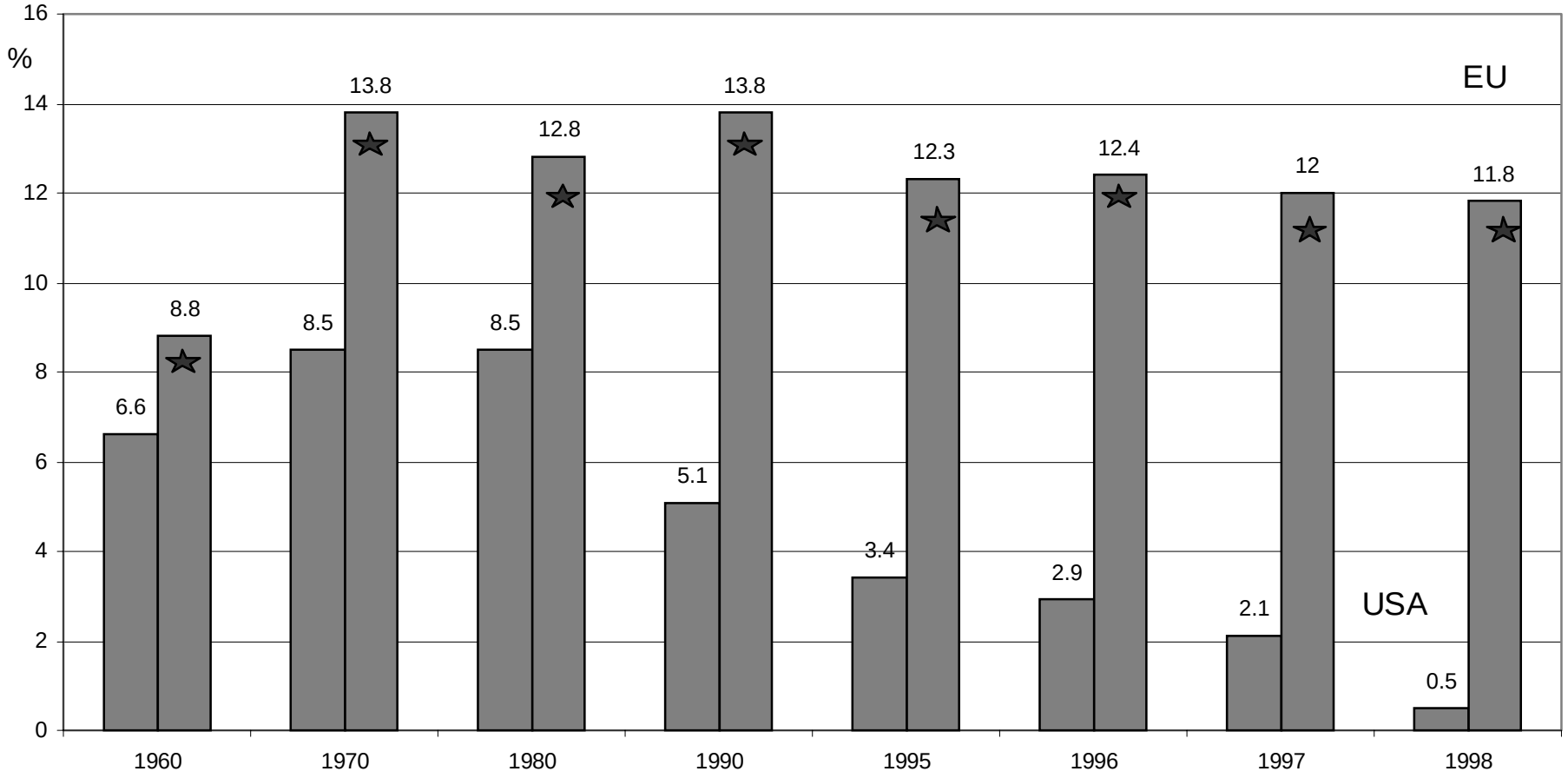
Chart 2: US Saving lower - (a) Ratio of Personal Saving



Sources: Council of Economic Advisers; Statistisches Bundesamt; Bundesbank;
Ratio Pers. Saving = pers sav as % of disposable income; (EU = Germany only)

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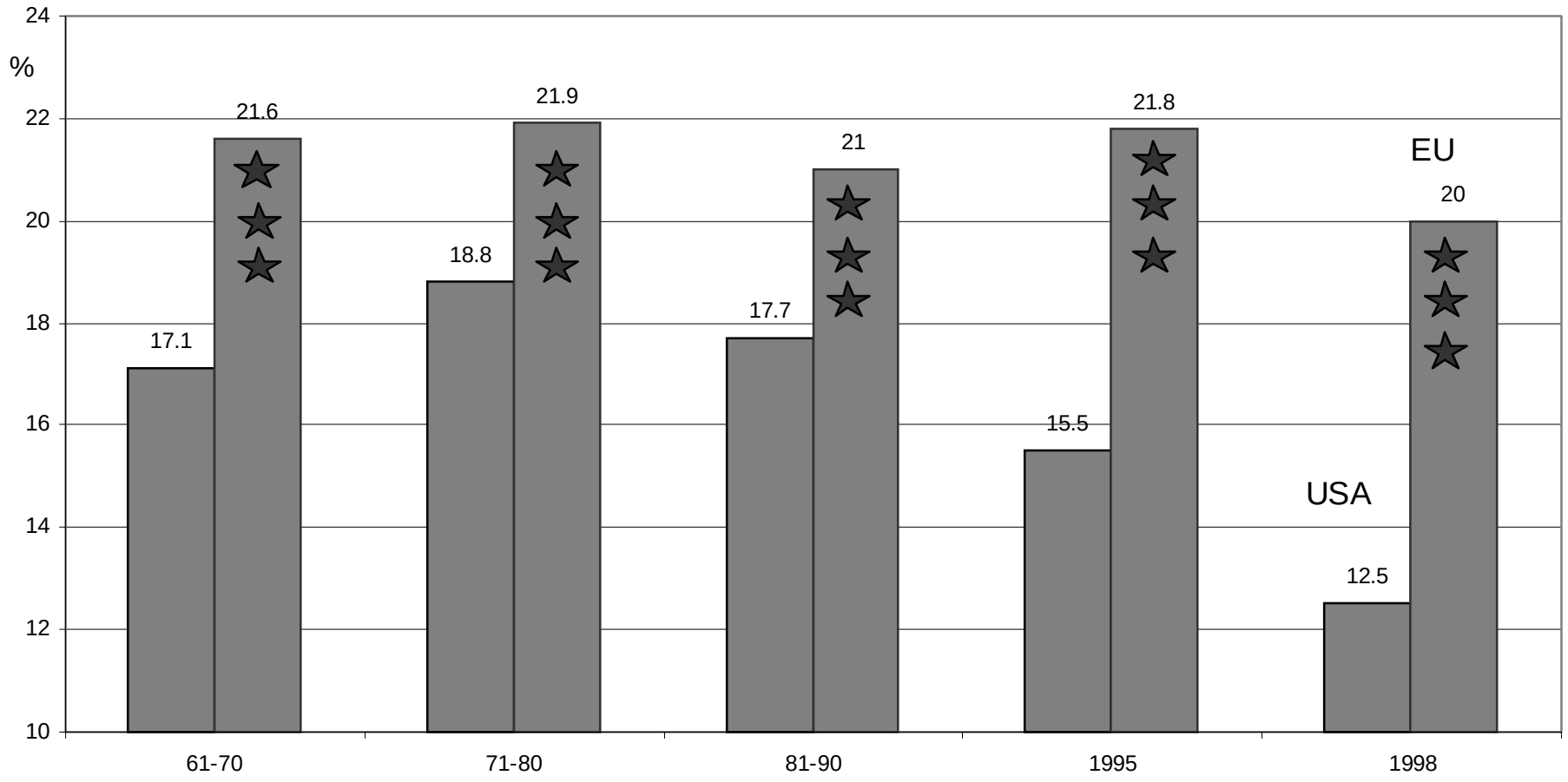
Chart 3: US Saving lower – (b) Saving in Private Sector



Source: EU Commission (DG Econ+Fin);
Gross Saving priv Sector as % of GDP; EU-14

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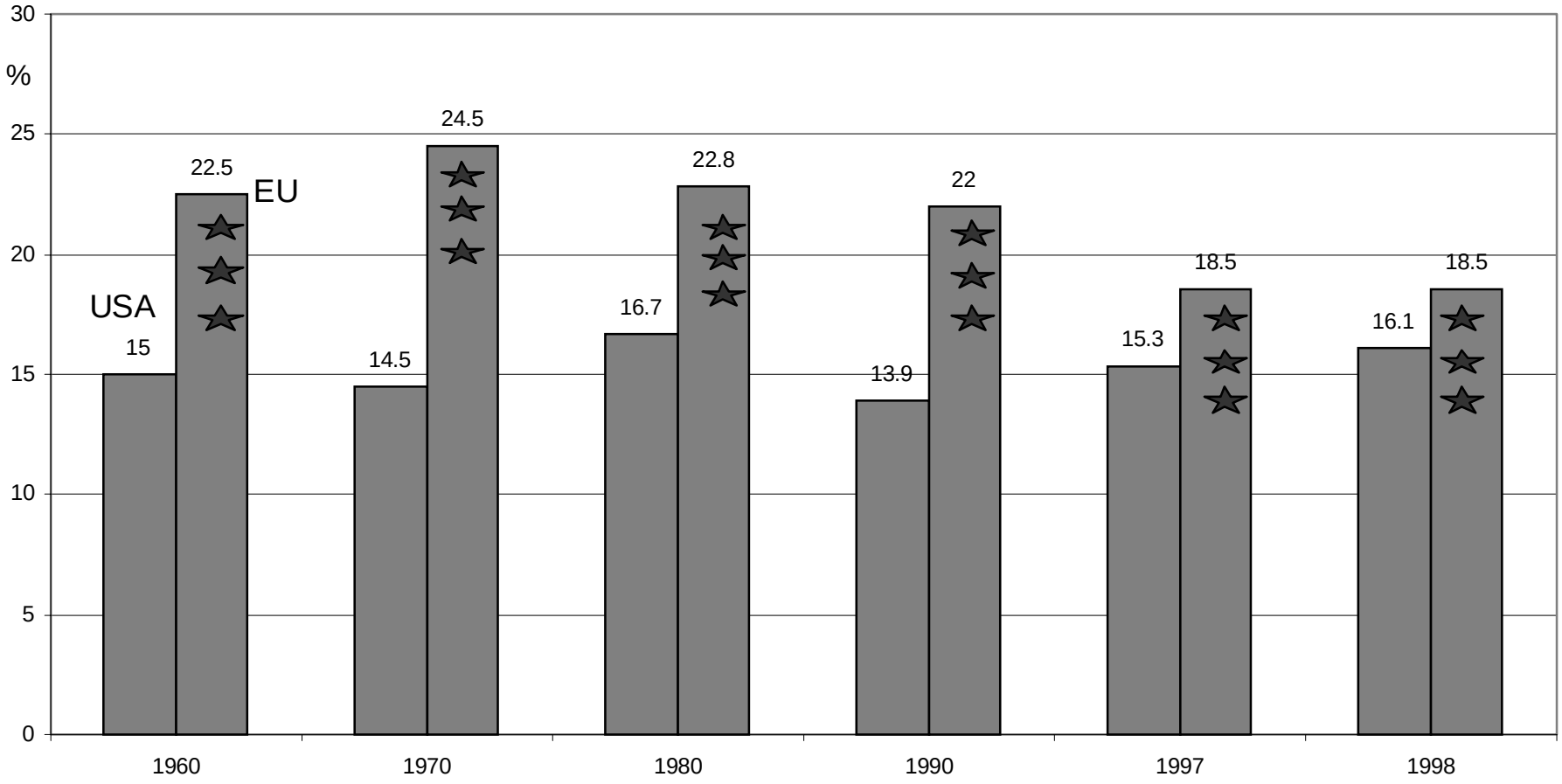
Chart 4: EU and US Investment Shares



Sources: EU Commission (DG V); Council of Economic Advisers; Department of Commerce;
Investment as % of GDP

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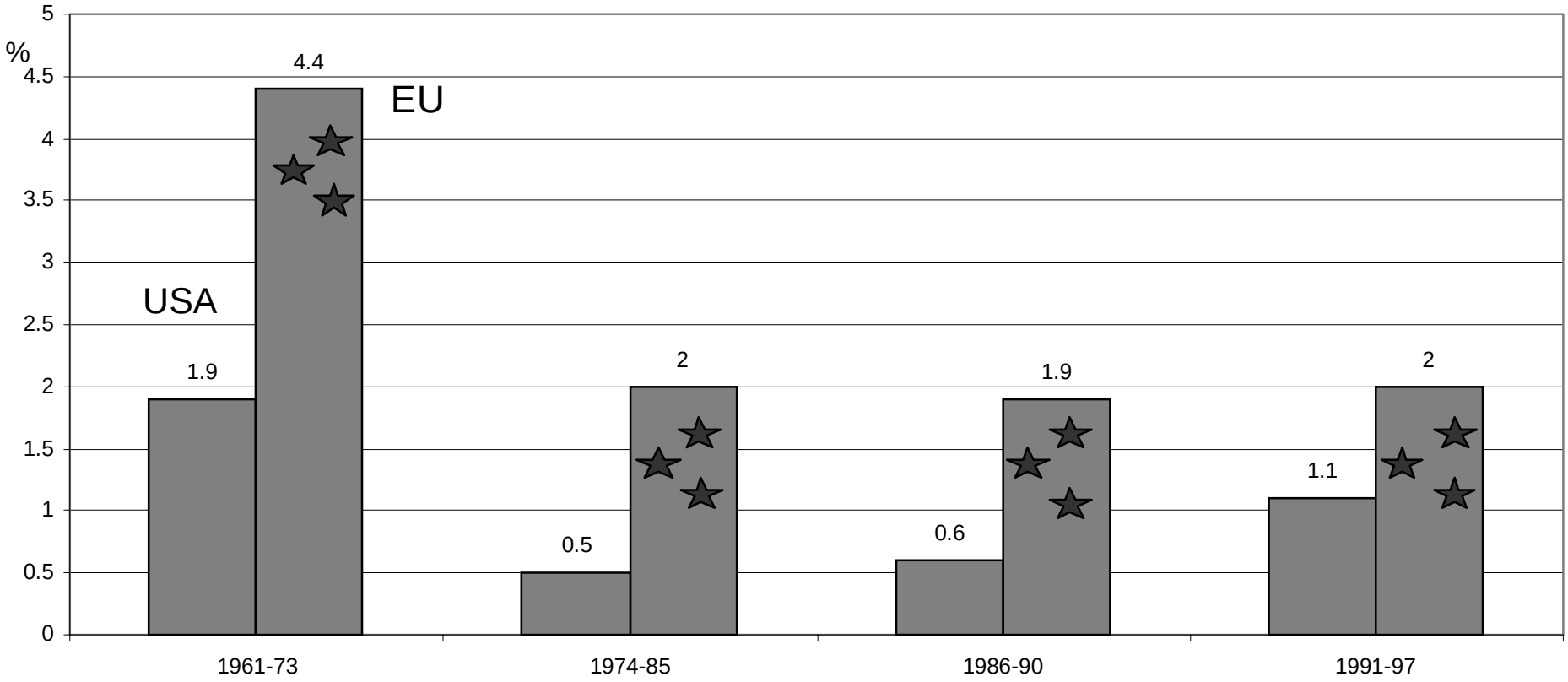
Chart 5: EU and US: Growth of Productivity



Sources: OECD; EUROSTAT, Ifo Munich;
GDP per hours worked

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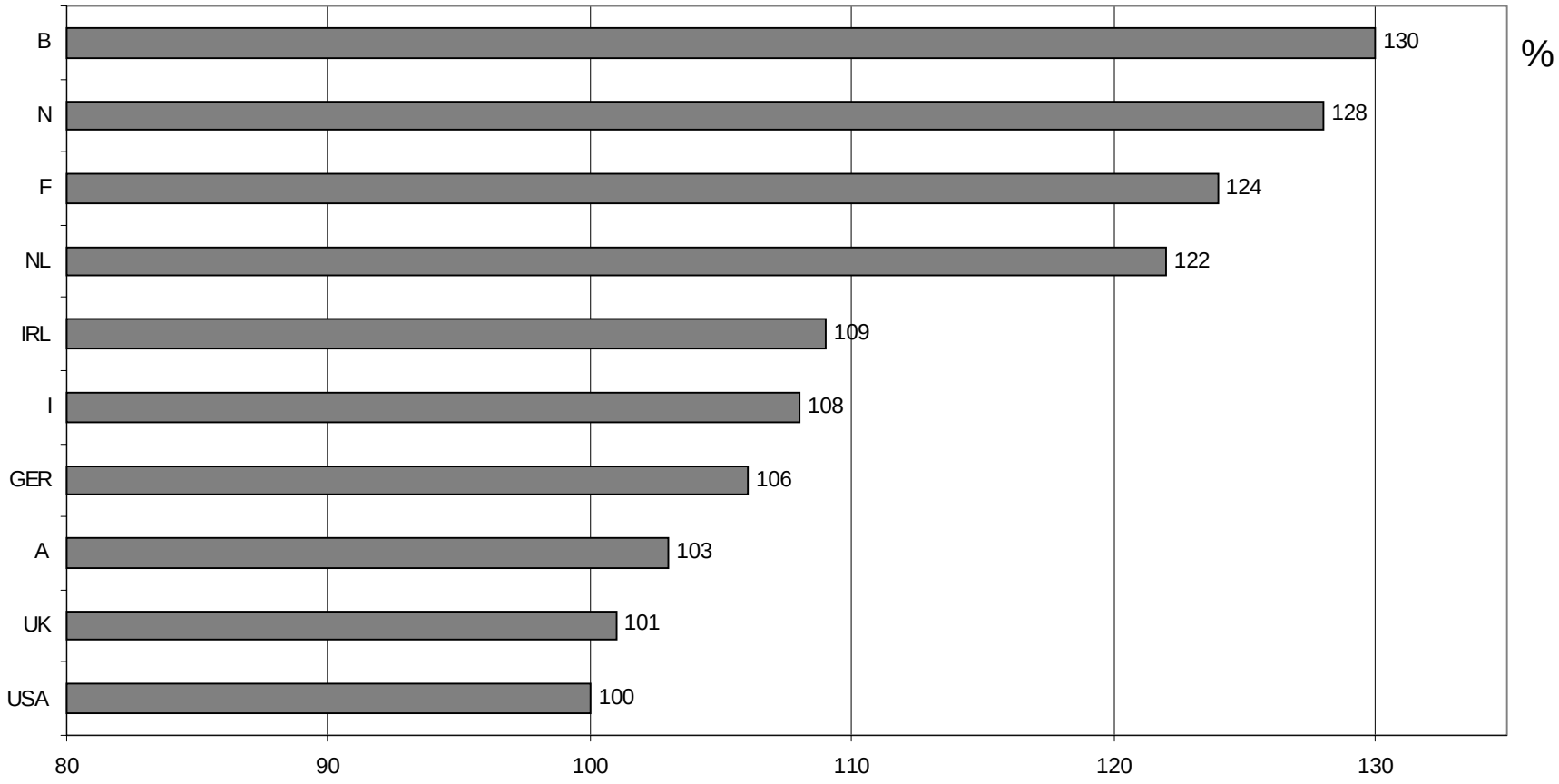
Chart 6: EU and US: Level of Productivity (1997)



Source: The Conference Board N.Y.;
GDP per hours worked, (US worker = 1,966 h per year)

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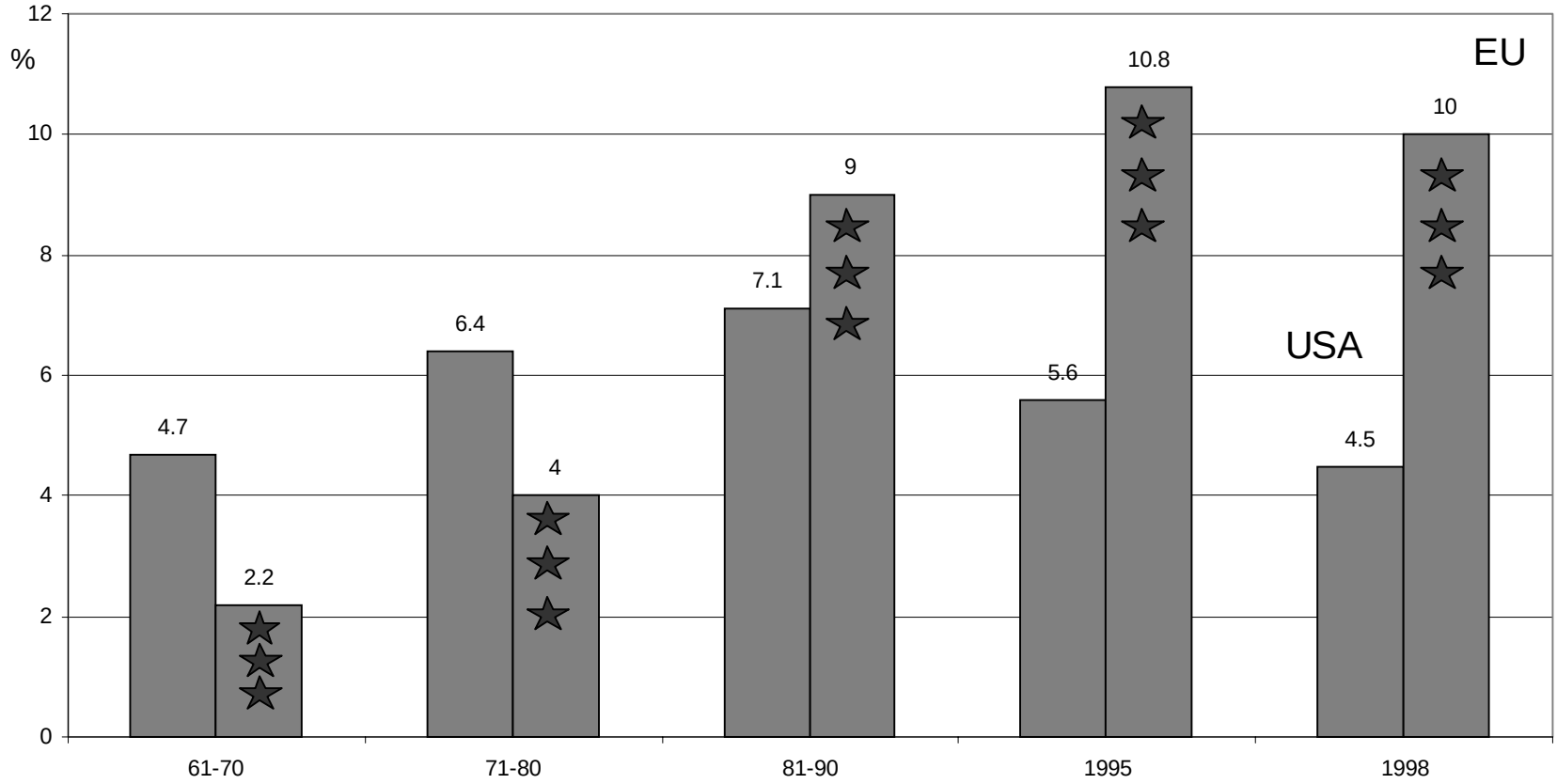
Chart 7: EU + US Unemployment Rates



Source: EU Commission (DG Econ+Fin);
as % of Civil Labor Force; definition EUROSTAT; EU-15

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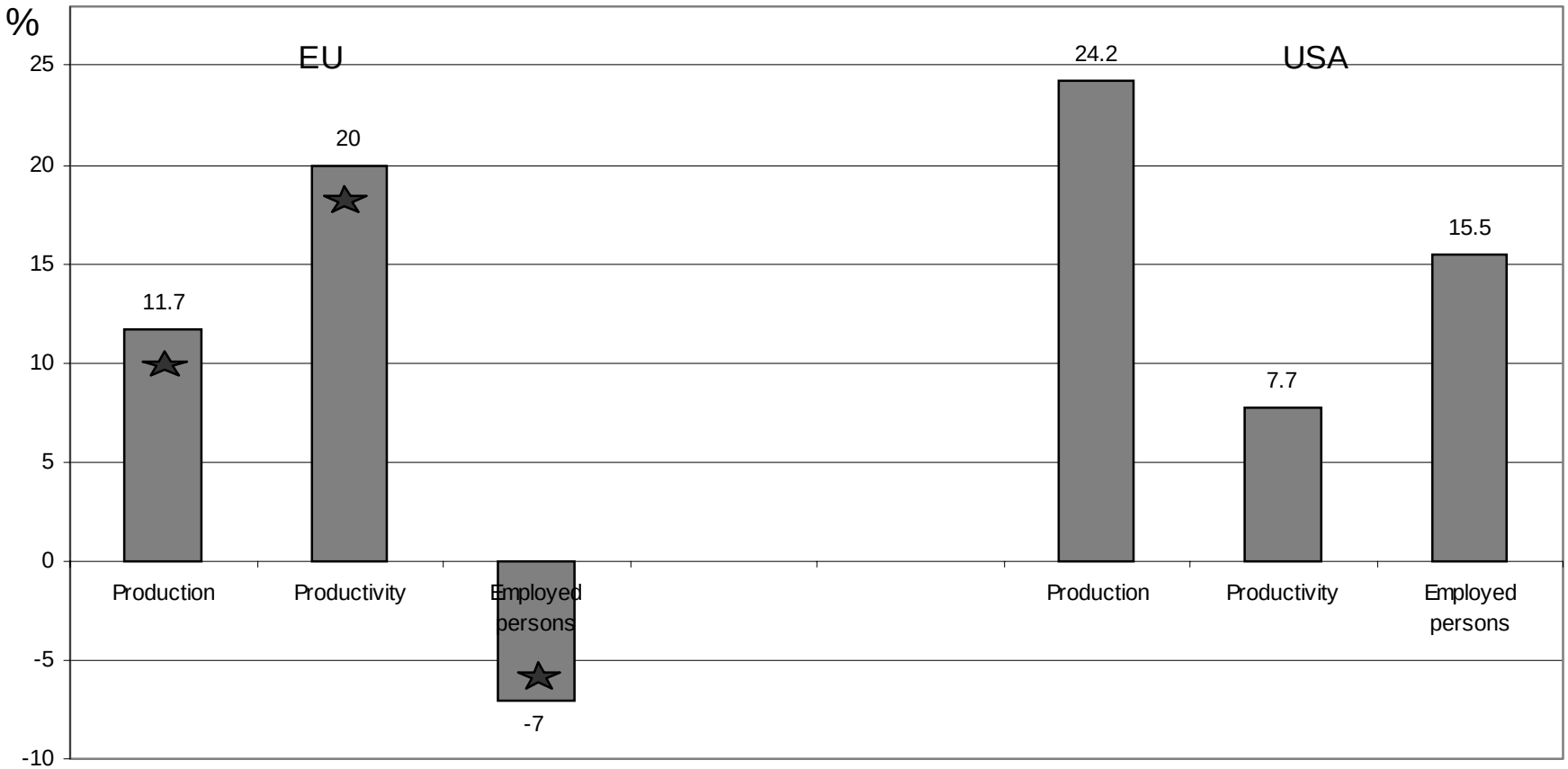
Chart 8: Productivity as Key Determinant



Source: OECD, Nat. Accounts;
Production = real GDP nat. currency; P'tiv = real GDP per employee; growth in % 91-98; (EU = Germany only)

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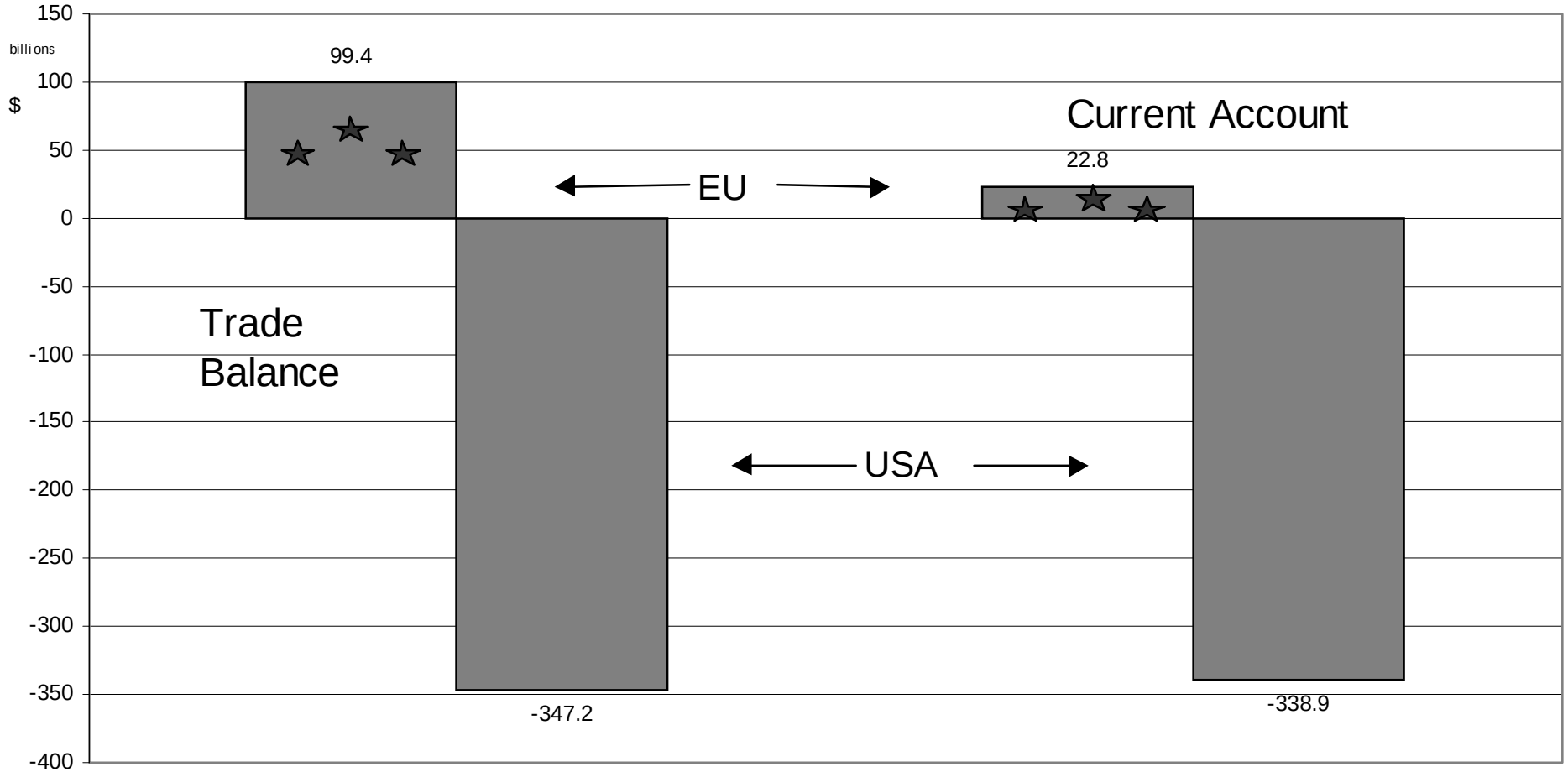
Chart 9: EU and US: Competitiveness on Foreign Markets 1999



Sources: European Central Bank and Department of Commerce;
(External Euro Area Trade Balance; Trade Bal. = goods)

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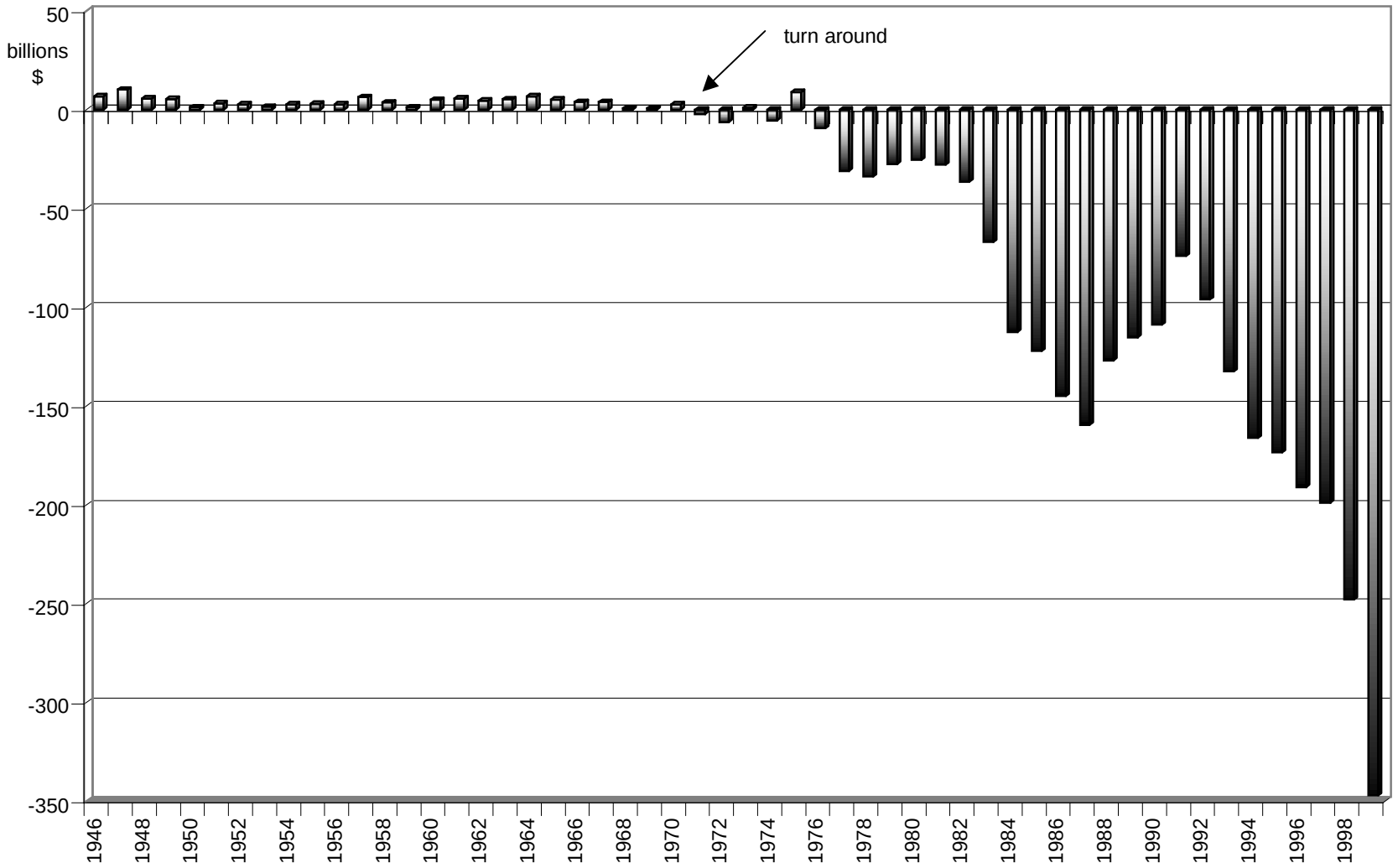
Chart 10: Long-term Development of the U.S. Trade Deficit



Sources: Council of Economic Advisers; Department of Commerce;
Trade balance = goods

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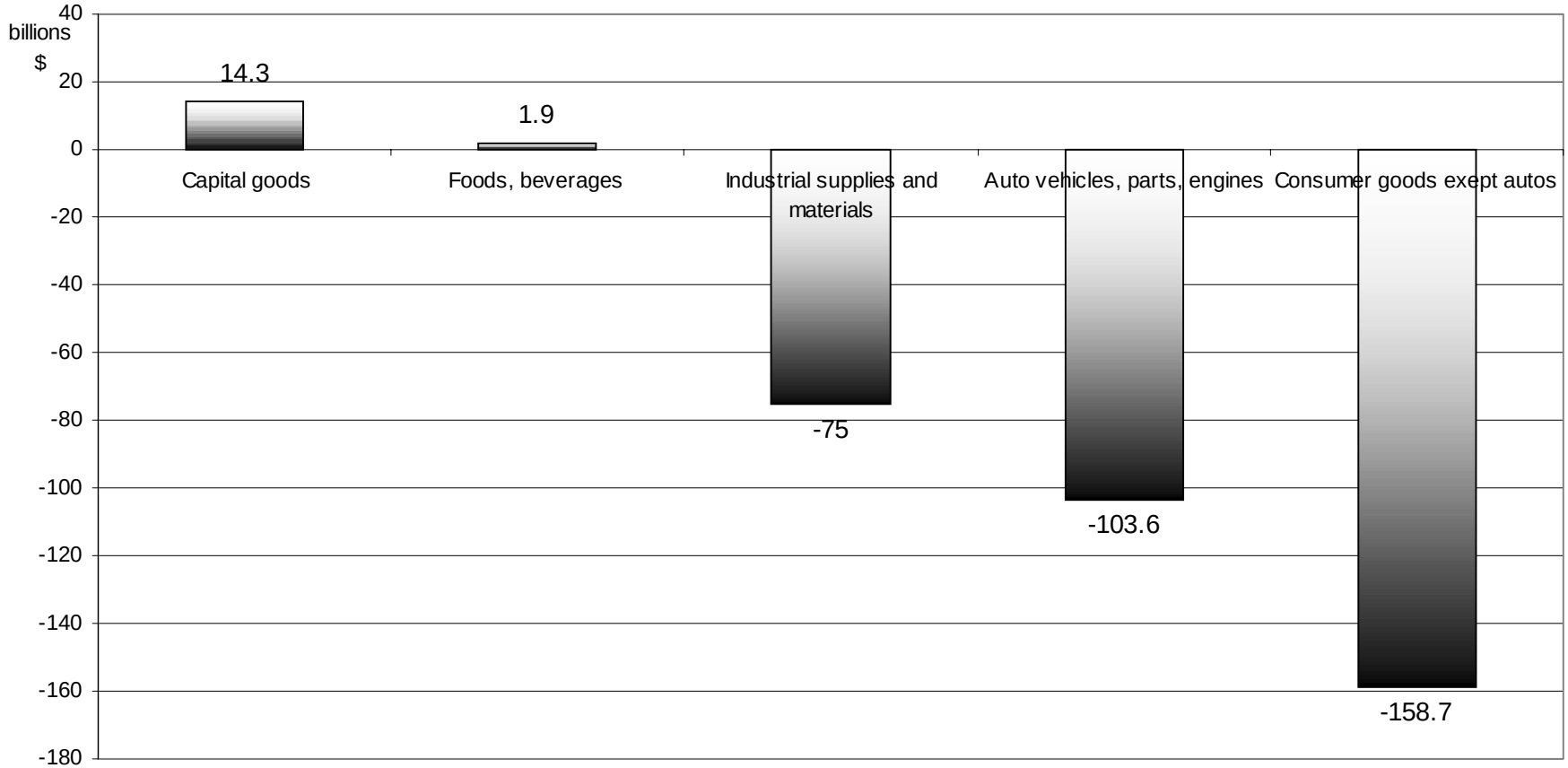
Chart 11: In which Subsets are the Deficits? (end-use categories 1999)



Sources: Council of Economic Advisers; Bureau of Economic Analysis;
(X-M) by principal end-use Category, monthly data seasonally adjusted

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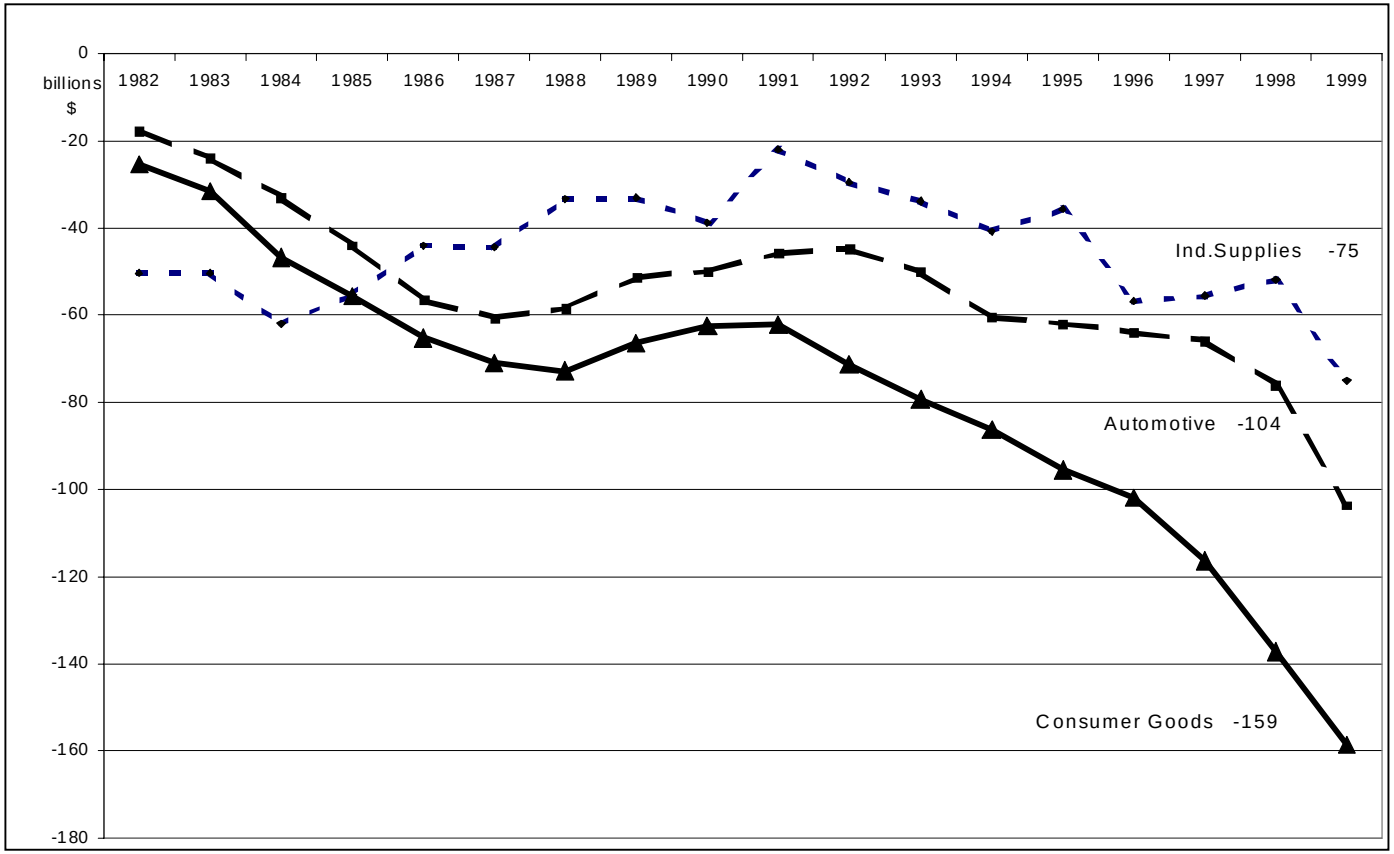
Chart 12: Long-term Export Deficits in US Manufacturing Sectors



Sources: Council of Economic Advisers; Bureau of Economic Analysis;
(X-M) by pricipal end-use Category, monthly data seasonally adjusted

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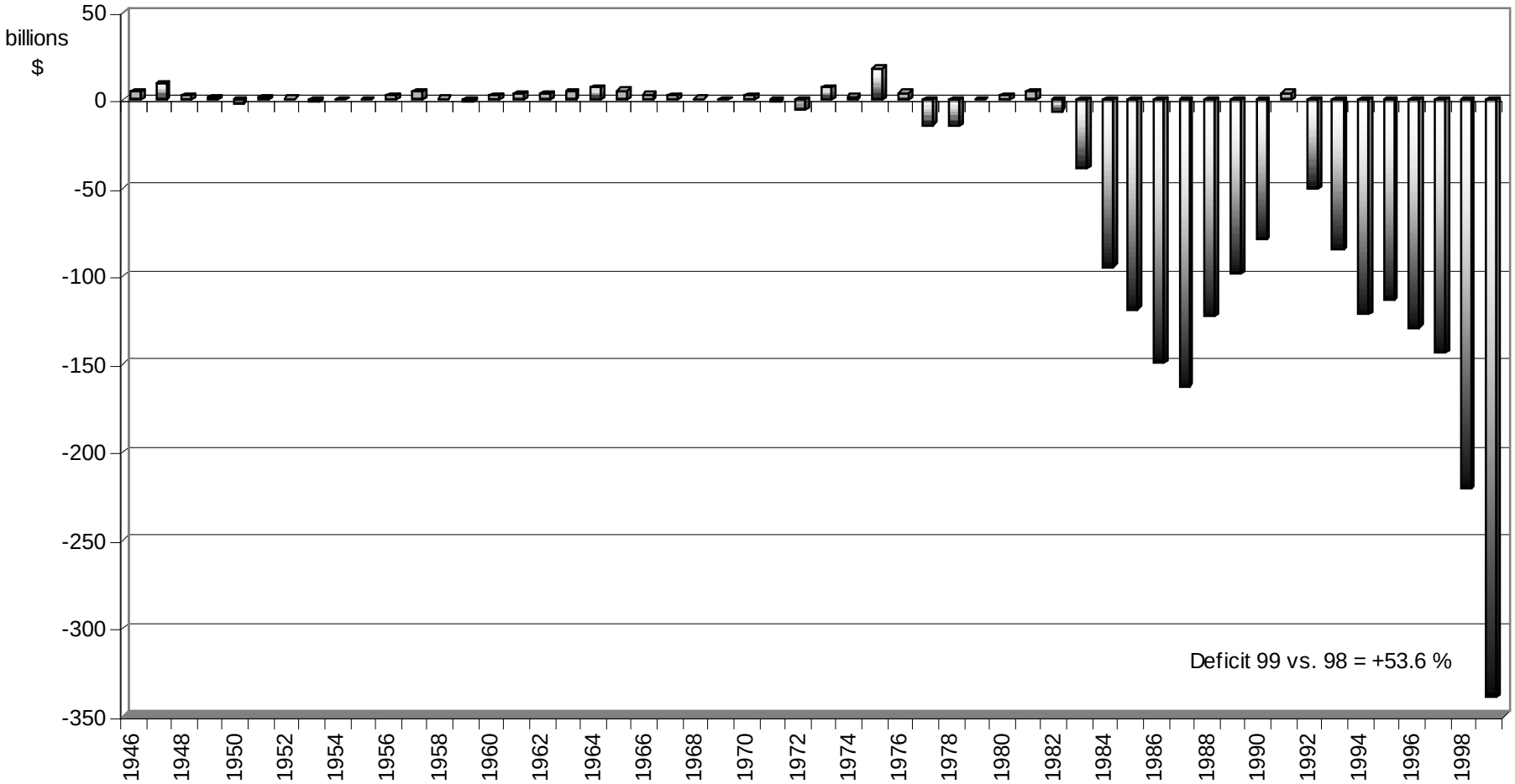
Chart 13: Long-term Development of the Balance of Current Account



Sources: Council of Economic Advisers; Dept. Of Commerce;

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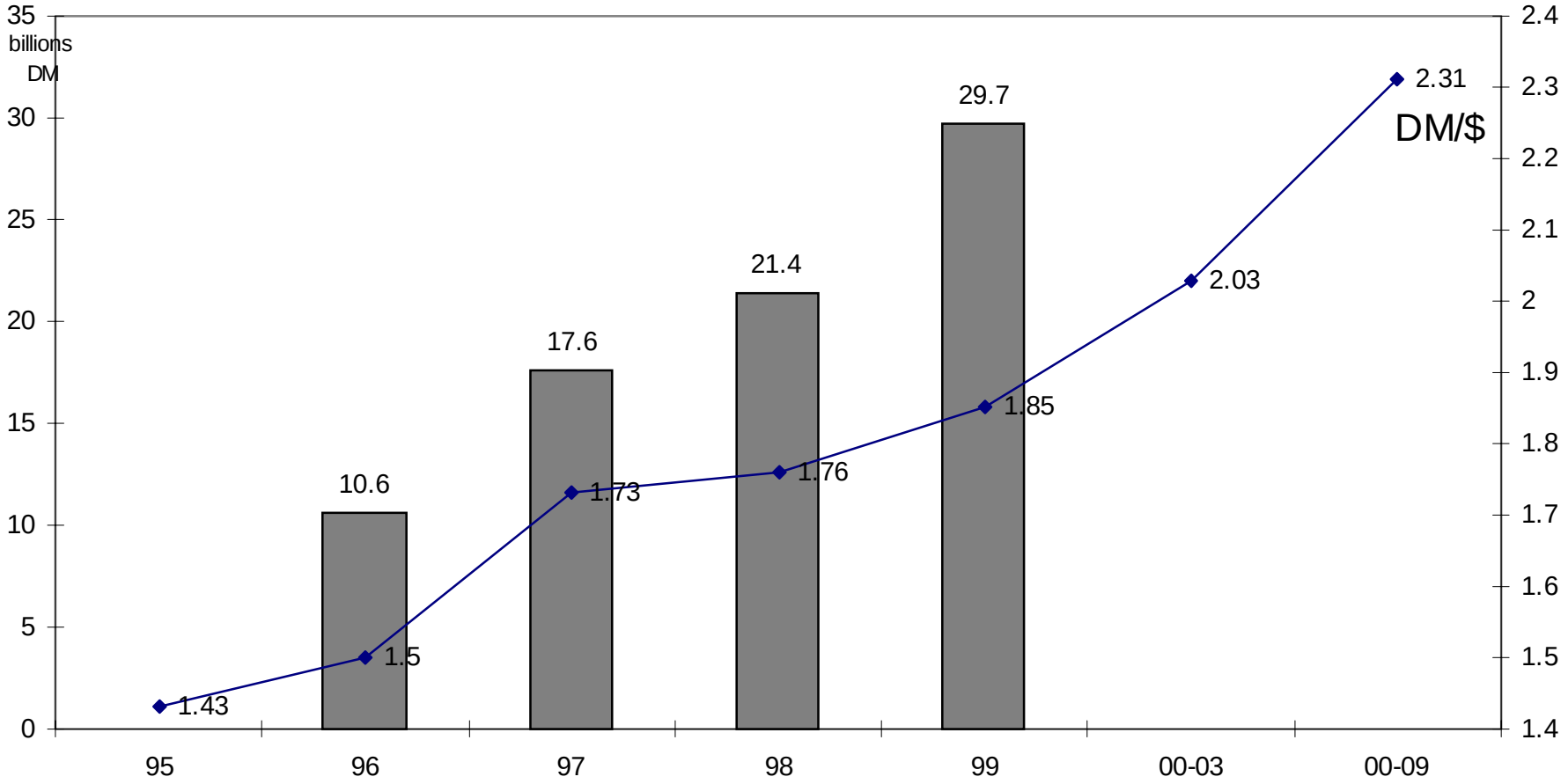
Chart 14: Depreciation of the DM(Euro) and German Export Surplus to USA



Sources: Bundesbank; Statistisches Bundesamt;
Exchange rates since 99 identical with changes of the EURO

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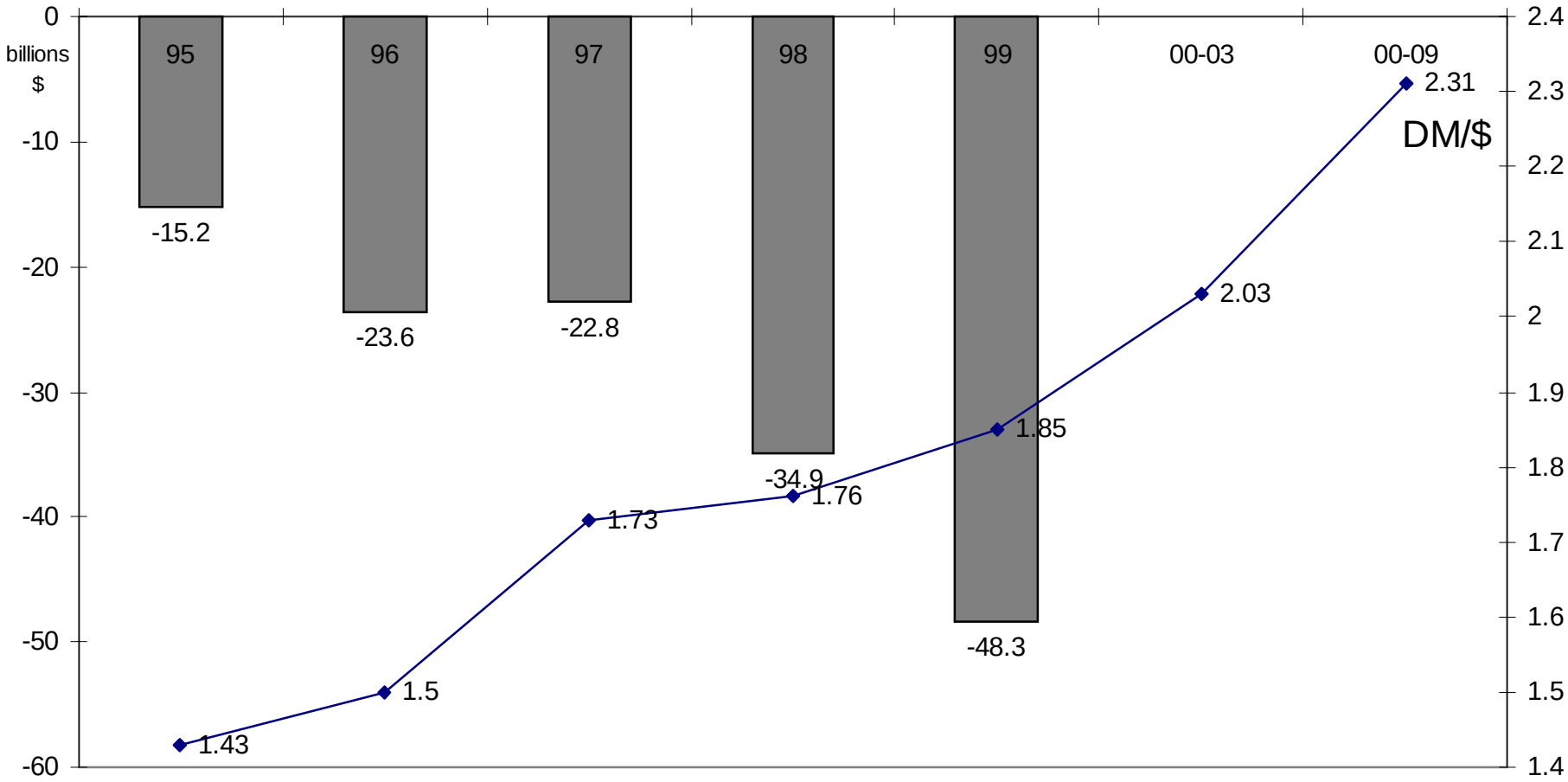
Chart 15: Appreciation of the Dollar and US Export Deficit with West Europe



Sources: FederalReserveBank; Bundesbank;
1999 projected on base of first three quarters

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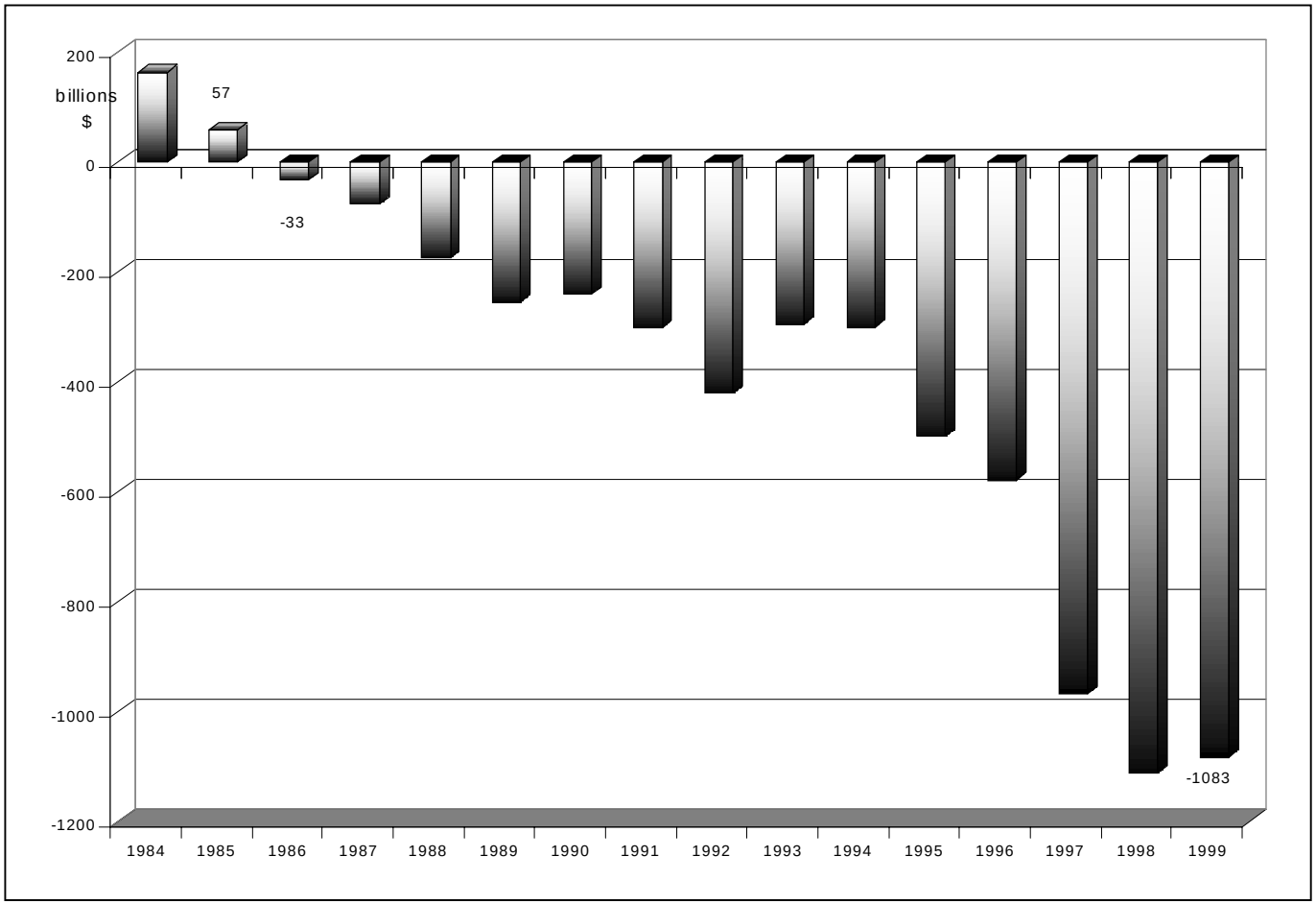
Chart 16: US Net International Investment Position



Sources: Bureau of Economic Analysis;
Net Int. Inv. Pos. = at current cost

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