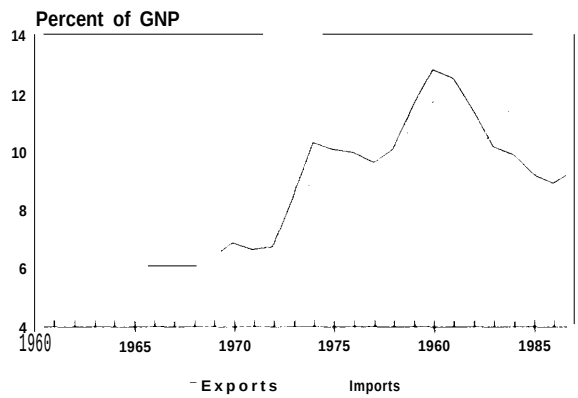
U.S. Trade Performance

A nation's economic health can be measured in many ways. Common measures include Gross National Product, per capita income, wages and unemployment rates, life expectancy, literacy rates and educational attainment. The balance of international trade is one important indicator of the ability of a nation's firms and industries to compete internationally. A nation's economic and technological strength and weaknesses are reflected in its trade figures.

In the mid-1980s, for the first time in recent history, the trade accounts of the United States have gotten seriously out of balance. In the 1950s and 1960s, the U.S. was accustomed to running modest trade surpluses. In the 1970s and early 1980s, small deficits began to appear, but both deficits and surpluses remained lower than one percent of GNP. In the mid- 1980s, the trade deficit ballooned; in 1987, the current account deficit was a record-high $161 billion, or 3.6 percent of GNP[2] Before 1983, the current account surplus or deficit had not exceeded 1.2 percent of GNP.[3]

Simultaneously, the importance of international trade to the American economy was growing: imports of goods and services increased from 4.7 percent of GNP in 1960 to 12.2 percent in 1987, while exports expanded from 5.8 percent to 9.5 percent (figure 4).[4] The expansion was not smooth. In 1980, exports totaled nearly 13 percent of GNP, and have since fallen in percentage terms. Imports grew at about 8 percent per year, on average, from 1980 to 1987; meanwhile, exports grew unevenly, falling and then rising again for an average annual growth rate of

Figure 4
Goods and Services Trade, Percent of GNP
1960-87 "



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts, Table 1.1, 1987 electronic data,

2 The United States keeps account of trade balances using a variety of partial balances, as discussed below.

3 U.S. Department of Commerce, Bureau of Economic Analysis, The National Income and Product Accounts of the United States, 1929-82, (Washington, DC: U.S. Government Printing Office, September, 1986); and U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, various issues.

4 Ibid.

3.2 percent over the period. Before 1983, exports and imports tended to grow or fall together, as percentages of GNP. It is the marked divergence of imports and exports that accounts for the unprecedented deficits of the 1980s.

The dominance of the United States in world markets in the 1950s and 1960s was never expected to be a permanent condition. Europe and Japan were rebuilding their industrial bases after the devastation of World War II, often using newer and more efficient technologies. The international trading system of the General Agreement on Tariffs and Trade, and various programs of economic development aid, were designed to help both war-ravaged industrial nations and developing countries along. The fact that many newly industrialized nations in Asia and Latin America were able to achieve rapid growth in the past few decades is at least partly testament to the success of such programs. Often, in order to develop or rebuild, developing and developed countries alike controlled access to their own markets, using them as incubators for their own developing industries. While these developments can all be viewed positively, as contributing to world economic growth and development, they have also begun to present problems for American industries. Limited access to many foreign markets presents problems for U.S. exporters, while relatively open access to our own market given to countries such as Japan, Taiwan, West Germany, South Korea, etc. increases the competition at home.

In short, the fact that American dominance in world goods markets has slipped is expected and even partly self-imposed. So why do we view our trade deficits as a problem? In part, the speed of the decline in the late 1970s and throughout the 1980s has been unsettling; but more fundamentally, we are concerned that the responses U.S. manufacturers and government have made to the decline are inadequate to stem further losses. The losses are beginning to hurt. Many manufacturing industries are in trouble, employment has fallen, whole communities in older industrial areas are in decline, and wages of manufacturing workers have stabilized well below their historical peak, in real terms. The trade deficit, then, is a manifestation of a set of problems that could well become much worse.

Proposals for "solving" the deficit are nothing if not diverse, ranging from upgrading the skills of the workforce to crafting new ways of dealing with unfair trade. Some observers counsel little action at all. They see the deficit as self-correcting, and caution that government interference with trade regimes or factors determining trade will prove counterproductive in the end. Different views on what should be done — or not done–about the trade deficit stem partly from different opinions on the importance of its causes. Regardless of the policy prescription, however, an overview of the composition of the trade deficit makes it clear where the potential problems are, and equally important, where they are not.

What is the Trade Deficit?

Strictly speaking, there is no such thing as "the trade deficit." Most often, "the trade

deficit" is synonymous with the merchandise (or goods) trade deficit, which is only one of the partial balances commonly used to express the position of the United States in international flows of goods and services. There is no single indicator that accurately and wholly reflects this position.[5] Rather, international flows of goods, services, and capital are included in the U. S. balance of payments statements (table 1). Partial balances —such as the current account, the merchandise trade account, and the balance on goods and services –reflect the net debit-

Table 1.– Simplified U.S. Balance of Payments Statement

Credits (receipts)	Debits (payments)
Current accounts:	Current accounts:
1 U S merchandise exports	1. U S. merchandise imports
2 U S services sold to foreign residents a Foreign tourist expenditures in the U.S. b. Fees and royalties from foreigners c. Transportation, insurance and other private and government services d Receipts of income from U S (government and private) investments abroad	2. Services purchased from foreign residents a. U.S. tourist expenditures abroad b. Fees and royalties paid to foreigners c. Transpiration, insurance and other private and government services d. Payments of income on foreign (government and private) investments in the U S
3. Unilateral transfers received from abroad a. Private remittance b Pension payments c Government grants	3. Unilateral transfers sent abroad a. Private remittance b. Pension payments c. Government grants
Capital account:	Capital account:
1 Net change in investment by foreigners in the U S. a Direct investment b. Indirect investment c Foreign bank loans to U S residents d Deposits by foreigners in U S banks e Other	1. Net change in U S. investment abroad a. Direct investment b. Indirect investment c. U.S. bank loans to foreigners d. Deposits by U S. residents in foreign banks e. Other
2 Net change in foreign official reserve assets in the U S a U S Government securities held by monetary authorities b. Other dollar and dollar -denominated assets held by foreign monetary authorities	2. Net change in U S official reserve assets abroad a. Gold b. Special drawing rights (SDRs) c. U S. reserve position in the IMF d. Foreign currencies
3 Allocations of special drawing rights (SDRs)*	
Total credits	Total debits

● Capital account 3 has an entry only in years when the International Monetary Fund allocates SDRs to member countries

SOURCE Arlene Wilson, "U S Trade and Payment Balances. What Do They Mean?" Congressional Research Service Report 85-26E (Washington, DC: Library of Congress, 1985)

5 Arlene Wilson, "U.S. Trade and Payments Balances: What Do They Mean?" Congressional Research Service Report No. 85-26 E, January 23, 198.5.

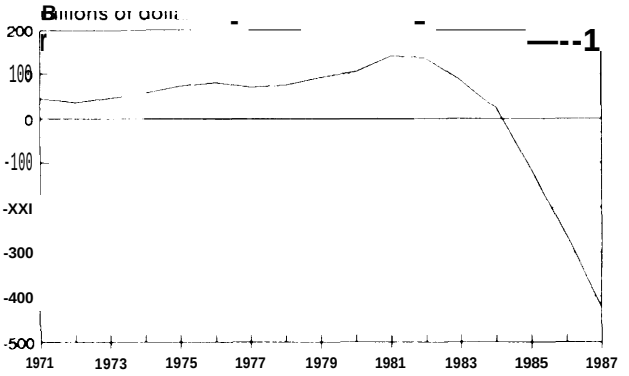
credit position of that part of U.S. international trade and transactions.

The entire balance of payments account must, as the name implies, balance. Its two components, the capital account and the current account, mirror each other, at least in theory.[6] A current account deficit must be balanced by a capital account surplus of the same amount; without capital funds coming in from abroad, something else would have to give — consumption, investment imports, government spending, or all four.[7] The current account measures international flows of goods, services, and unilateral transfers, while the capital account includes flows of direct and indirect investment and changes in official reserve assets.

The current account– the most comprehensive measure of trade in goods and services — was relatively stable for two decades following World War II, becoming more volatile after 1970 and plunging deeply into deficit after 1981 (see figure 1). The capital account, therefore, had to show a corresponding surplus –also unprecedented. As a corollary, the international investment position of the United States has shifted from surplus to deficit in the 1980s, roughly balancing the shifts in the current account. That is, foreign investment in the United States exceeded American investment offshore by nearly $424 billion in 1987 (figure 5). This infusion of capital allows the United States to sustain its current account deficit, or to consume more goods and services than it produces.

A nation's ability to consume more than it produces is attractive from the standpoint of the consumer–while it lasts. In this sense, the current account deficit has benefitted many Americans in the short term. But a nation cannot go on forever paying for its current account deficit through a surplus in the capital account. The capital account surplus consists of savings from other nations, which are invested in the United States in order to

Figure 5.
Net U.S. International Investment Position



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, June, 1987, U.S. International Transactions, table 1

provide future returns. Those returns will eventually drain away funds that, if they had gone into the hands of U.S. nationals, might have been used for American consumption, investment, or public spending. Moreover, foreign investors cannot invest larger and larger amounts of money in the United States indefinitely. At some point, con-

e In practice, there are differences (called statistical discrepancies) between the dollar amount of the capital and current accounts. Moreover, the capital and current accounts do not necessarily balance at any particular point in time it may take many months for the adjustments in one account to cause changes in the other to show up. For a discussion of these accounts and explanations of the items in each account, see Arlene Wilson, op. cit.

7 For further discussion of the relation between the current account deficit and an influx of foreign capital, see the section on The Causes of the Deteriorating Trade Balance, The Macroeconomic Argument.

fidence that U.S. investments can continue to yield higher returns, or more reliable returns, will erode, or the supply of foreign savings will be curtailed, and the massive flows of foreign capital into the United States will dry up.

No one can pinpoint the time when this will happen. But most analysts expect that foreigners will cease to finance our large current account deficit within a few years at most.

The trade deficit for 1988 promises to be smaller than the one in 1987– the first change in this direction since 1980. While this reduction in the trade deficit is relatively small, further, more consequential changes in our current account are coming, and they will necessitate adjustments on our part. What kind of adjustments? To get some insight on this question, it is helpful to look at the components of international trade – what kinds of goods, services, or other exchanges are most important to trade, and where the United States is running its biggest deficits.

Manufacturing and the Merchandise Trade Deficit

The current account measures what we commonly think of as international trade – exports and imports of goods and services, plus unilateral transfers.[8] The merchandise trade deficit, reflecting international flows of goods, is larger than the current account, mainly because the United States runs a surplus in international trade in services. In 1987, the current account deficit was $160.7 billion, with a surplus of $14.3 billion in services trade and a deficit of $159.2 billion in merchandise trade.[9]

To reduce the current account deficit, the United States must reverse the deficit in merchandise trade.[10] Surpluses in services alone cannot make much of a dent in the current account; they are dwarfed by the deficit in merchandise trade. Two kinds of activities are included in the services accounts: investment income (e.g., dividends and interest), and trade in services such as banking, insurance, travel, and license and royalty payments. In 1987, investment income, according to Commerce Department figures, produced a surplus of $14.5 billion, but trade in service activities was slightly in deficit, to the tune of $200 million.

In an earlier assessment, OTA found that the official figures have consistently understated the surplus from services trade (banking, travel, and the like) .11 For example, the Commerce Department figures showed a small surplus for services trade of $2 billion in 1984, whereas the OTA mid-range es-

a Unilateral transfers include U.S. Government grants (excluding military grants of goods and services), U.S. government pensions and other transfers, and private remittances and other transfers.

9 The remaining deficit of $12.8 billion was accounted for by unilateral transfers. In this section, trade figures are drawn from the national income and product accounts, which are calculated by the Commerce Department's Bureau of Economic Analysis on the free-along-side (f.a.s.) basis. Other trade figures, kept on a more current basis by the Commerce Department's International Trade Administration, calculate imports on the cargo-insurance -freight (c.i.f.) basis. Imports figured on the c.i.f. basis are higher, and thus make the U.S. trade deficits appear higher (or the surpluses lower).

10 Much of this section depends on a presentation entitled "U.S. Trade Deficits and International Competitiveness," by Allen Lenz, former director, Office of Trade and Investment Analysis, Department of Commerce.

11 U.S. Congress, Office of Technology Assessment, Trade in Services: Exports and Foreign Revenues, OTA-ITE-316 (Washington, DC: U.S. Government Printing Office, September 1986), ch. 4.

timate of the surplus for that year was $14 billion. Nonetheless, even using OTA estimates, the surplus for services is small compared to the merchandise trade deficit. Furthermore, the surplus from services trade was shrinking in the years OTA made its calculations (1982 to 1984). Investment income has been quite considerable in previous years, peaking at $34.1 billion in 1981, but it too is declining. Because the United States is now the world's leading debtor, it seems likely that investment income will continue to decline for some years.

Are services on the brink of assuming much greater importance in international trade, perhaps eclipsing goods? OTA judges that they are not. Goods can be shipped and stored; services, by and large, cannot. Most services are produced very near the place they are consumed. For that fundamental reason, goods are much more important to international trade than services and are likely to remain so for a longtime. This situation may change as telecommunication becomes cheaper and more reliable, but the changes are likely to be gradual, not revolutionary. Moreover, it is not realistic to think of services trade as a replacement for trade in goods. The manufacture of goods and provision of services is highly interdependent. If American-made goods become more in demand and sell better around the world, many services will be bundled along with sales of those manufactured items. For example, the companies that have succeeded best in selling computers in the world market are also very good at providing services such as systems integration, training, maintenance of hardware and provision of up-to-date software.

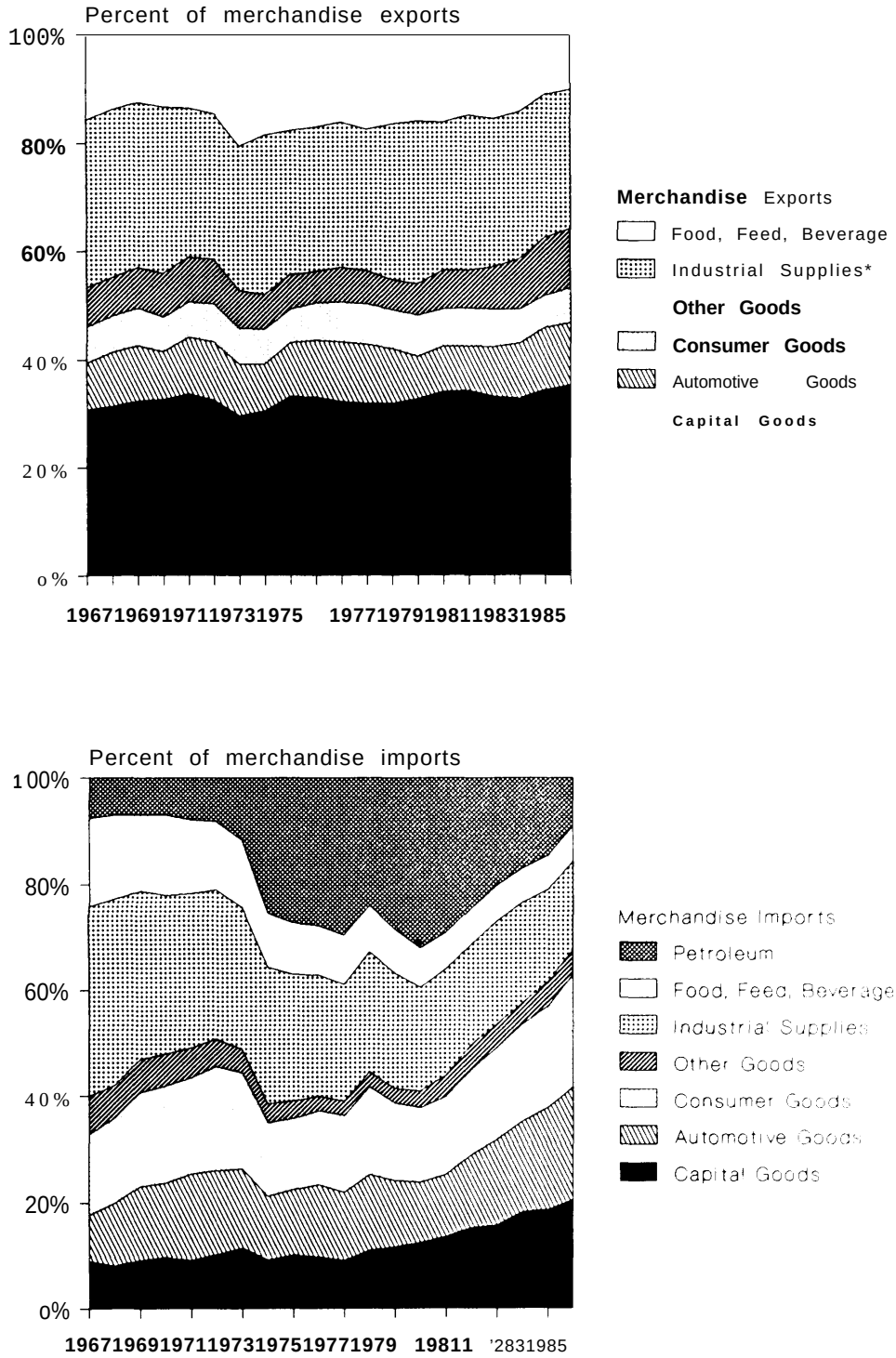
For different reasons, agriculture cannot do much either to reverse the current account deficit. Agriculture, where America is generally thought to be internationally competitive, contributed fairly strong trade surpluses in the 1970s, helping to offset the petroleum deficits of that time and to keep the current account more or less in balance during the decade. But agricultural trade surpluses have dwindled in recent years. Farm support programs and the widespread dispersal of production-enhancing agricultural technology throughout the world have reduced the potential for American exports. Even if U.S. agriculture were to recover some foreign markets, agricultural trade, like trade in services, is too small to much affect the huge merchandise trade deficits of the 1980s.

Manufactured goods dominate merchandise trade. (Figure 6 shows the composition of merchandise trade over the past two decades.) About 80 percent of merchandise trade, both imports and exports, is in manufactured items. Thus, most of the merchandise trade deficit – and therefore, the current account deficit — is in manufactured goods. The great deterioration of the 1980s in the merchandise trade balance was due almost entirely to manufacturing. The deficit in petroleum trade, once a major drag on merchandise trade balances, improved by over $40 billion between 1981 and 1986, as oil prices fell and U.S. production increased, though this situation is temporary. The agricultural trade surplus declined from $25

12 U.S. Congress, Office of Technology Assessment, International Competition in Services, OTA-ITE-328 (Washington, DC: U.S. Government Printing Office, July 1987), ch. 1.

13 For reasons why this is so, see U.S. Congress, Office of Technology Assessment, U.S. Oil Production: The Effect of Low Oil Prices, Special Report (Washington, DC: U.S. GPO, In Press).

Figure 6.
Composition of U.S. Merchandise Exports and Imports 1967-86



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, Business Statistics: 1986, ('Washington, DC: U.S. Government Printing Office, 1987), Appendix II, U.S. International Transactions, p. 246; U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, March, 1988, p. 44-46

billion to $3.4 billion. But the trade balance on manufactured products, having fluctuated moderately during the 1970s, plunged into deep deficit in the 1980s (see figure 2). Despite the upturn in exports in 1987, the manufacturing trade balance dropped to a record deficit of $138 billion as imports of manufactured goods continued apace.

One way to reverse the current account deficit is for U.S. exports to grow much faster than imports, and continue doing so for some time. But this is now likely. If import growth continues unchecked, it is highly unlikely that exports could grow fast enough to close the trade deficit; this would require extremely rapid expansion of exports, and assumes an improbably high rate of growth in world markets. It is more likely that U.S. import growth will slacken or reverse, either because of a recession that cuts consumption, or because the falling dollar makes imports too expensive for Americans to afford, or because we replace some imports with domestic production. At the same time, exports are likely to pick up, as foreign firms and consumers adjust to lower-priced American products. Indeed, U.S. merchandise exports grew consistently throughout 1987, rising to $258 billion. The degree to which exports can expand further will depend on many factors, including the value of the dollar, the competitiveness of U.S. manufacturing firms, and the economic and trade policies of many countries, not least our own.[14] The following section considers how these same factors were involved in causing the deepening trade deficits of the 1980s.

14 Why the trade deficit must turn around and how it may occur is discussed in more detail in the concluding sections of this report.