

»» No turn of the tides in U.S. trade

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Up until the economic and financial crisis, the U.S. trade deficit showed clear signs of widening. It began to fall as early as in 2007 and appeared to have stabilised on a lower level after the crisis.

But the structure of U.S. trade has not changed. The improved U.S. trade position after 2006 was merely a crisis effect. Imports continue to be driven by domestic consumption demand, which is usually very dynamic. Exports are growing at the same rate at best. That is not enough to durably improve the trade deficit position. In fact, a moderate trend to a higher deficit has been visible since 2013.

Inducing greater export performance would be a possible approach which the USA had already taken by launching a (temporary) export offensive. But that would require creating an even more strongly export-oriented economic structure, especially in the SME sector, and that structure is not yet adequately in place.

Improved current account and trade balance since 2007

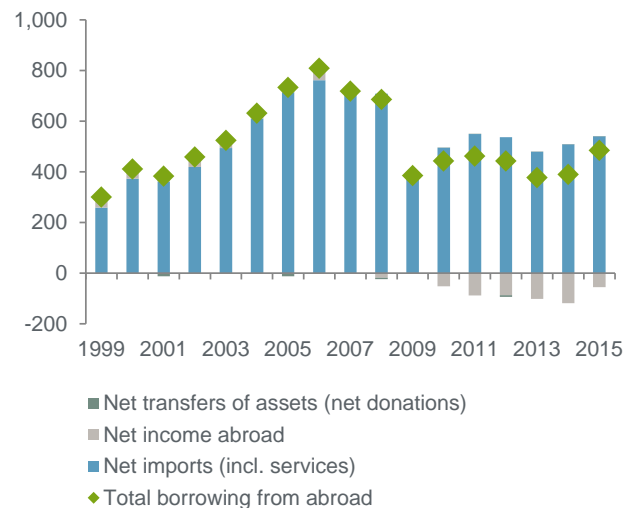
The U.S. has long been criticised for what is known as its "twin deficit". Simultaneous and persistent budget and trade deficits (more imports than exports) are seen as problematic.¹ The national budget is still in deficit, but that deficit has contracted significantly since the economic and financial crisis of 2008 and 2009.² The external deficit shows a similar development. Annual U.S. borrowing from abroad by all sectors and economic subjects has fallen from some USD 810 billion in 2006 (just under 6% of GDP) to USD 380 billion in 2013 (almost 2½% of GDP) before expanding again slightly to USD 480 billion in 2015 (close to 3% of GDP).³ In principle, there can be three basic reasons for an economy to run a deficit towards the rest of the world:

- Imports exceed exports, that is, demand for goods exceeds supply from domestic production; the balance of trade (including services) is in deficit.⁴
- Income outflows to the rest of the world from labour, capital and one-sided money transfers without compensation are higher than income and transfers received from abroad; the income balance (primary and secondary incomes) is in deficit.
- Donations made to recipients in other countries exceed those received; the capital account balance is in deficit.

The first two points are items in the balance on the current account while the third point (balance on the capital account) constitutes a sub-balance in its own right. Figure 1 shows that the volume of U.S. borrowing from abroad is mostly determined by the trade balance, as it is in many other economies. The income balance slightly reduced the deficit in the past years and asset transfers did not play a role.

Figure 1: Net U.S. borrowing from abroad

In USD billion



Source: BEA, own calculations

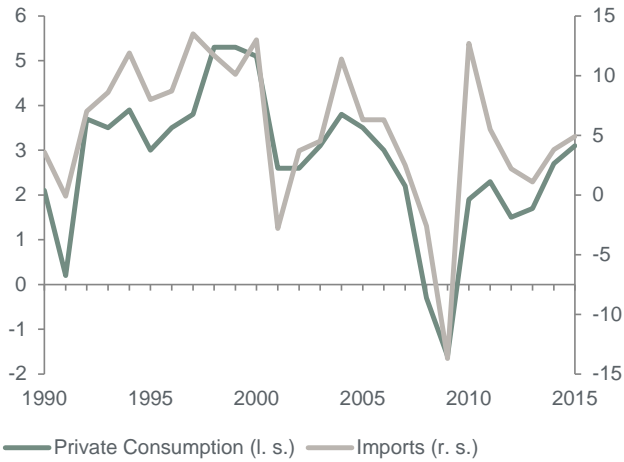
The decrease in net borrowing from abroad and, correspondingly, the improvement in the trade balance, began as early as in 2007. This might provide hope that structural changes will influence U.S. trade towards a deficit reduction. Should this indeed materialise, it would signify continuing debt reduction – at least in the medium term.

Deficit reduction from 2007 to 2009 was a result of the crisis

From 1990 to 2006, nominal U.S. exports grew by an annual average of about 6½% while nominal imports increased by approx. 8¼%. Accordingly, the trade deficit grew almost continuously during that period, from around 1.4% of GDP in 1990 to 5½% in 2006. After 2006, however, imports initially began to grow more slowly than exports – presaging the crisis. U.S. households' rising interest payments were putting pressure on disposable incomes, which were growing more slowly, sapping the momentum of private consumption. This, in turn, affected imports, which are traditionally linked relatively closely to the development of private consumption (Figure 2).

Figure 2: Real imports and real private consumption

Variation on previous year in per cent



Source: BEA

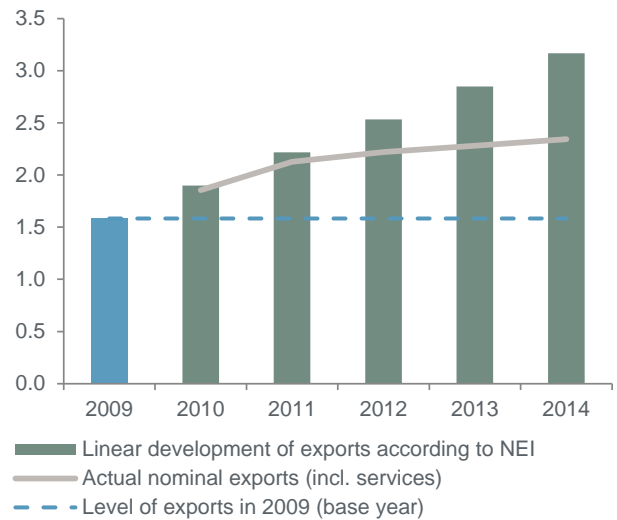
During the ensuing recession, imports decreased much more strongly than exports, reducing the trade deficit very significantly. Notably, this included the demand for imported automobiles and commodities, which together dropped by 30% nominally from 2007 to 2009. The trade deficit eventually improved to 2.7% of GDP in 2009. However, this improvement from 2007 to 2009 was nothing but the response of domestic demand to the (beginning) crisis. It therefore did not represent a change in the U.S. trade structure.

After the crisis: deficit is trending up again

After the economic and financial crisis was overcome, the pre-crisis trend of expanding the trade deficit was (seemingly) not resumed. In 2015 the trade deficit was 3.0% of GDP, only slightly higher than in 2009 (Figure 4). One structural reason for this could be that the U.S. had committed to strengthening its export industry after the economic and financial crisis. At the initiative of President Obama, the "National Export Initiative" (NEI) was launched in 2010 with the aim of, among other things, doubling exports between 2010 and 2014.⁵ The external trade position indeed improved in 2012 and 2013. But the figures reveal that the stability of the trade deficit since 2009 (in relation to GDP) cannot be attributed to stronger exports. After the crisis, export growth was even weaker than before, averaging around 6% per annum. The initiative also clearly missed the target of doubling exports by 2014 (Figure 3).

Figure 3: Nominal exports

In USD trillion

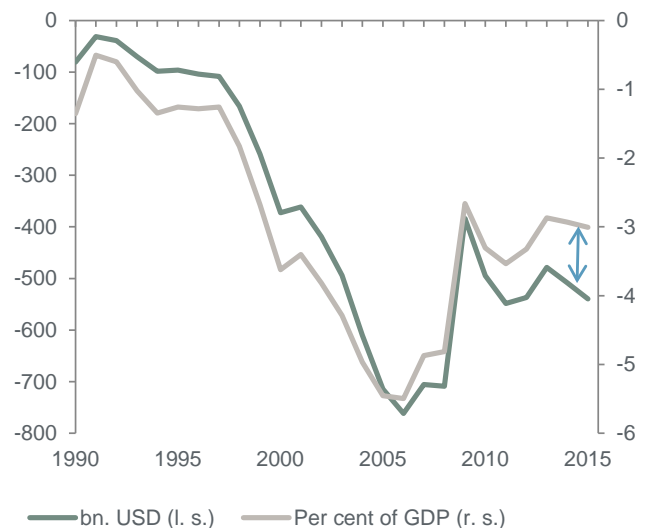


Source: BEA, own calculations

The stability of the trade balance as a percentage of GDP therefore cannot be explained by an above-average increase in exports. In the first instance the cause is rather that the widening of the trade deficit after the crisis is not expressed as a ratio to GDP, unlike in the past (Figure 4). If we base the trade balance exclusively on the goods balance (that is, without services), the divergent development following the crisis is even more dramatic.

Figure 4: Nominal trade balance

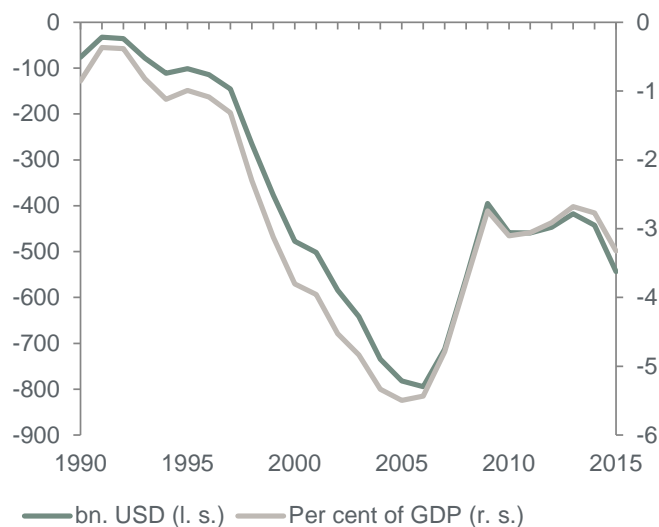
Incl. services



Source: BEA, Feri

This discrepancy between the trade balance and its relation to GDP, however, is caused only by price effects. After the crisis, the growth in import prices slowed down more strongly on average than that of the GDP deflator, with falling commodity prices also playing an important role. At the same time export price dynamics hardly changed. In effect, the nominal trade balance and nominal GDP developed more synchronously than before the crisis. Conversely, that means the gap between the absolute trade balance and the trade balance in relation to GDP is not apparent in real terms (Figure 5).⁶

Figure 5: Real trade balance



Source: BEA, own calculations

This shows that the U.S. has not once and for all broken the trend towards widening its external trade deficit and, hence, continuing to borrow from abroad. The widening trend has emerged again, especially in the last two years. Economic growth was roughly 2½% each year in 2014 and 2015, a high level for post-crisis conditions. The same applies to private consumption, which increased 2.7% and 3.1%, respectively. As private consumption and imports remain closely correlated (Figure 2 again), this also translates into increased imports.

The U.S. trade deficit is still far from the levels it reached in the years immediately preceding the crisis. But if the trend continues, most notably of the last two to three years, the deficit on the current account could move towards pre-crisis levels again. The IMF expects the (nominal) deficit on the current account⁷ to widen from 2.7% in 2015 to over 4% of GDP by 2020.⁸

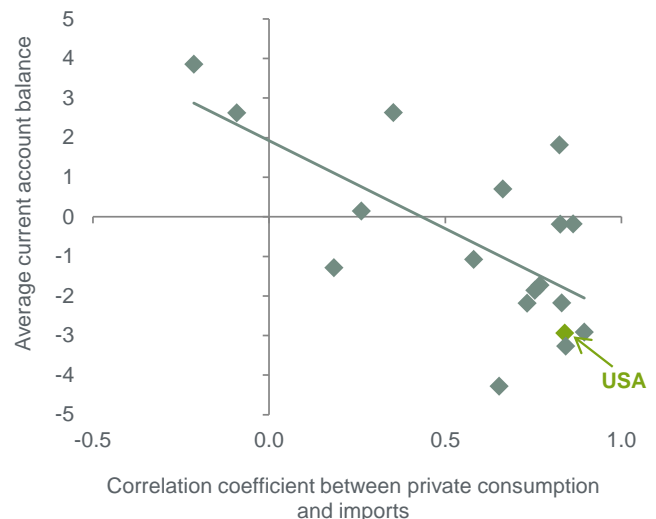
The solution: boost exports – vigorously, not half-heartedly

The trend to a renewed widening of the trade deficit is therefore hardly surprising. Countries such as the USA, where a close correlation exists between consumption and imports, have a stronger tendency to accumulate current account deficits (Figure 6) because rising domestic incomes are reflected to a significant degree in rising consumption and

hence rising imports. In order to reverse this constellation through export growth, exports would have to grow at a higher rate than imports on a sustained basis.

Figure 6: Correlation between consumption and imports, current account balance

G 20 countries (without Saudi Arabia and Russia) plus Spain, 1990 to 2015



Source: IMF, Feri, own calculations

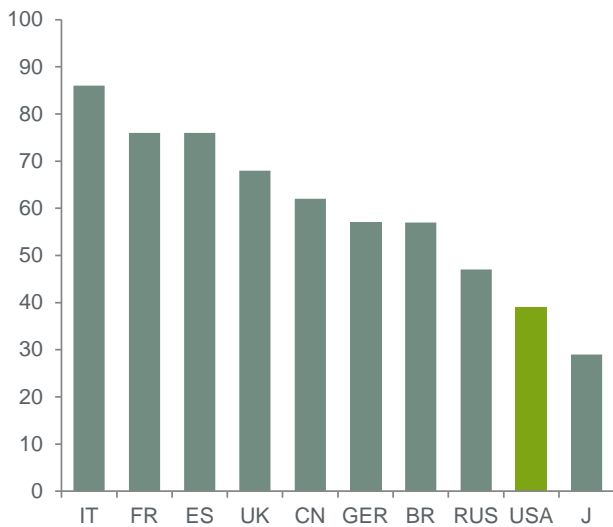
The idea of the NEI to strengthen the export industry and thereby bring about lasting improvements to the net exports was therefore good in principle. But the initiative petered out – not least because its assumed annual export increase implied two-digit growth rates, even in real terms. That was entirely unrealistic.

The following reflection may illustrate the difficulty of merely stabilising the balance of exports and imports in real terms. Assuming future annual real import growth of 3½% (which is roughly the average growth rate since 2011, the post-crisis period not counting the "catch-up year" 2010), real exports would have to rise 4 to 4½% each year to sustain the real net exports of 2015 (around USD -540 billion) in the long term. Such export growth is not entirely unrealistic, given that much sharper increases occurred before the crisis. Nevertheless, in the past such a growth rate was not steady either, but alternated with weaker years. Besides, this reflection does not take into account the mentioned feedback effects on consumption and imports. Assuming import growth accelerates to a rate of 5½% within ten years, exports would have to grow progressively to some 6½% in order to keep net exports steady in real terms. That also illustrates that the U.S. economy would actually have to become much more open to trade than it is today to keep the external deficit under control in the long term. In the latter scenario the foreign trade ratio (exports plus imports over GDP) would rise from currently about 30% to some 40% (supposing the potential rate of 2% GDP growth). By comparison, Germany also has a relatively high correlation between consumption and imports, but a current account surplus, and lies in the top right quadrant of Figure 6. Its foreign trade ratio exceeds 80%.

An economy the size of the U.S. in particular, which has a very large domestic market, cannot achieve higher export growth without a large number of sufficiently export-oriented enterprises. Having a few large exporters is not enough, even if they are internationally successful or even market leaders. In other words, the U.S. needs a much more internationally oriented SME sector. According to the KfW Competitiveness Indicator, the U.S. SME sector has one of the world's lowest proportions of exporting enterprises (Figure 7).⁹ Unless that changes (that is, increases), the export growth rate of the U.S. economy will not be able to outpace import growth in the long term.

Figure 7: Export-oriented SMEs

Per cent of all SMEs (50 to 500 employees)



Source: KfW

This must be put into perspective, however. The fact that the U.S. has a low proportion of export-oriented enterprises by international standards does not mean that U.S. SMEs have no interest in trade. In a very large national economy such as the U.S., what businesses trade across domestic regions (e.g. state borders) would be international trade in other regions of the world. So it is more challenging for very large economies to have high proportions of export-oriented enterprises. Still: economies such as the EU or China demonstrate that this is fundamentally possible for large economies as well.

Conclusion

It is true that the U.S. trade deficit (and with it the deficit on the current account and its indebtedness to the rest of the world) is currently lower than before the crisis. However, this is not backed by any structural improvement. The reduction in the deficit is first and foremost a consequence of the enormous slump in demand and, hence, in imports in the wake of the economic and financial crisis. Since the end of the crisis a trend to a widening deficit has become visible again, especially in real terms.

In order to stop this trend, U.S. export activity would have to be stepped up significantly and, above all, sustainably. The U.S. had the right idea in principle with its National Export Initiative (NEI). To be successful the country would require an export-oriented SME sector – which it is lacking, however. Changing the economic structure in this direction is not easy and takes a long time. So the NEI's goal of not just doubling the volume of exports but doing this within a period of five years was much too ambitious. ■

¹ This is because twin deficits often indicate that an economy has a particularly serious debt problem. Theoretically, the public deficit and the external deficit can overlap significantly (when the public sector finances most of its debt from abroad), but external debt is very often reflected in several domestic sectors.

² See also Focus on Economics No. 78., Take It Easy? A look at the consolidation of public finances in the US, KfW Research, Januar 2015.

³ The figures reflect the aggregate balances on the current account and the capital account. Alternatively, the volume of borrowing can also be determined from the balance on the financial account (including financial derivatives and currency reserves). If all external transactions were captured in full and correctly, both methods would have to lead to the same result. But in reality this is almost never the case because it is not invariably possible to capture them statistically and rule out errors. That is why the balance of payments includes the item "net errors and omissions", which exactly balances out the discrepancies between the balances on the current account and the capital account and the balance on the financial account. In 2015, for example, according to the financial account balance, the U.S. borrowed only around USD 210 billion from abroad.

⁴ Following a common definition, the balance of trade only captures trade in (physical) goods but excludes services. Services are captured separately in the balance of services. For convenience, however, in the following we will apply the term balance of trade to the aggregate trade of goods and services.

⁵ President Obama officially promulgated the NEI by Executive Order (No. 13534) on 11 March 2010. He had already announced the target of doubling exports within five years (2010 to 2014) in his 27 January 2010 State of the Union Address.

⁶ Using GDP deflators constructed as chain indexes (as is the case here) for determining real GDP and its expenditure components means that real expenditures add up exactly to the reported real GDP only in the reference period (here 2009 in the case of the U.S.), while a difference remains in all other years. Strictly speaking, it is therefore inadmissible to establish ratios that place the individual expenditures in relation to GDP (the only exception being the year 2009). However, the error that arises when such ratios are established is very small and can therefore be neglected.

⁷ Owing to improved data availability, here we refer to the balance on the current account overall (including Figure 6), not just to the trade balance as in the preceding text. But that does not modify the meaning of the statement.

⁸ Cf. IWF, Article IV Consultation with the United States of America: Concluding Statement of the IMF Mission, June 2016.

⁹ A survey by the U.S. International Trade Commission arrived at a similar finding. It determined that almost 4% of U.S. SMEs export their goods while that percentage is twice as high on average across the EU. See United States International Trade Commission, Small and Medium-Sized Enterprises: U.S. and EU Export Activities, and Barriers and Opportunities Experienced by U.S. Firms, July 2010. The reason the percentages published in this study of export-oriented small and medium-sized enterprises in all SMEs differ so significantly from the results of the KfW Competitiveness Indicator is that they are based on different SME definitions. The KfW Competitiveness Indicator surveys larger enterprises on average and does not include very small SMEs with fewer than 50 employees. The share of export-oriented enterprises is therefore necessarily higher.