

How Do Competitiveness and Trade Policy Affect Sustainability?

Is the External Deficit Caused by Unfair Trade Practices?

The US trade deficit is at an all-time high because of our government's irresponsible trade policy. . . . [O]ur inability to insist on fair trade, especially with China, is forcing us down the wrong path.

—US Representative Sherrod Brown (D-OH), press release (17 July 1998)

But use of the trade balance as a measure of the success of market-opening endeavors is problematic. Changes in the trade balance are seldom related to specific market-opening efforts; indeed, the trade balance is generally determined by macroeconomic factors, not microeconomic barriers to trade.

—Council of Economic Advisers, *Economic Report of the President* (1998)

Most people agree that the US market is the most open in the world. It is equally clear that US exports face trade barriers in some foreign markets. If US exports face particularly high barriers in a certain country, it seems reasonable to think that the United States could have a bilateral trade deficit with that country, particularly if US consumers bought a lot of imports from the country. If such a bilateral deficit is quite large, it seems reasonable to think that reducing specific barriers facing US exports in that market would not only reduce that bilateral deficit but also would reduce the US overall trade deficit and contribute to the sustainability of the current account.

There are several fallacies in this reasoning. First, trade relationships between countries depend foremost on resource endowments and tastes,

on relative costs of production, and on technological choices, not on trade barriers (see chapter 3). Countries produce and demand different “baskets of goods” from each other; why should these baskets of goods and services be of equal value between all country pairs? Second, countries are not of the same economic size. Small countries might export a lot of a particular commodity to a large country like the United States, but buy only a small amount of a specialized service in return. The small country likely trades with several countries, not just the United States, to obtain the full range of products that it needs. Third, countries are at different stages of economic development, and hence demand different sets of products than any single country, such as the United States, has to offer. Finally, at any point in time, some countries could be in recession and therefore will import less. Given this range of variability, bilateral imbalances are almost an inevitable outcome of different resource endowments, tastes, levels of development, and cycles of economic activity; a zero bilateral trade account is rare indeed.

That said, *persistent* and large or increasing bilateral deficits that are not related to unique endowments may indicate barriers to US exports, particularly if a country is persistently in surplus with all of its trading partners and if the domestic prices of the products in question are far above the world price.¹ In any case, the magnitude of bilateral deficits, particularly when concentrated in certain industries, generates both politically heated debate and calls for protection or retaliation from the affected industries in the United States.

Reducing the barriers facing particular US exports in overseas markets certainly increases trade flows and helps the affected industries. But the key question in this chapter is whether such a change in specific barriers abroad and even specific bilateral trade imbalances would change the *overall* external imbalance. Chapter 2 showed that the US external imbalance comes from the difference between savings and investment in the United States. In order for bilateral trade negotiations with an individual trading partner to have an impact on the overall external balance, it must work through either the savings or the investment channel.

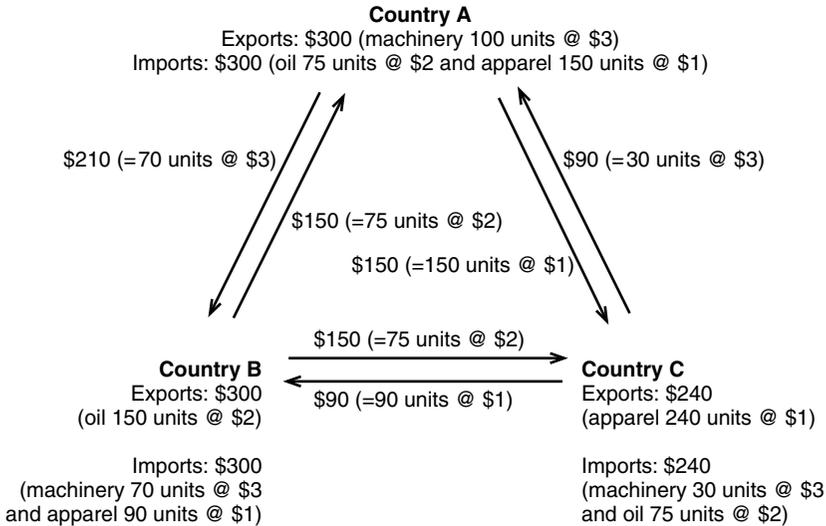
Sources of Bilateral Deficits

Trade Theory

Trade theory provides the underpinnings of how much and what kinds of products countries will trade with each other when all of a country’s resources are fully and efficiently employed. The basic principle, as noted in

1. If the domestic price of a product is well above the world price for the product, it suggests that trade is being restricted. Free trade would add supply, and the domestic price would tend to fall.

Figure 6.1 Trade patterns and bilateral balances



Summary

- (A to B) bilateral balance: $210 - 150 = \$60$ (surplus)
- (A to C) bilateral balance: $90 - 150 = -\$60$ (deficit)
- (B to C) bilateral balance: $150 - 90 = \$60$ (surplus)

chapter 3, is that a country exports those products for which it is a particularly well-suited producer—that is, for which it has comparative advantage. Can differences in comparative advantage lead to bilateral imbalances?

Figure 6.1 illustrates a simple example. Suppose there are three countries—A, B, and C—and three goods—machinery, oil, and apparel. Firms specialize in production of the good in which the country has the comparative advantage and export some of it. Country A has the comparative advantage in machinery and exports some of it. Country B has the comparative advantage in oil and exports 150 units at \$2 each. Country C has the comparative advantage in apparel and exports 240 units at \$1 each. Households in each country want to consume some of each good. Suppose each country's *overall* trade balance is zero, so the value of exports equals the value of imports. Country A imports 75 units of oil and 150 units of apparel. Country B imports 70 units of machinery and 90 units of apparel. Country C imports 30 units of machinery and 75 units of oil.

Although each country's *overall* trade account is balanced, none of the *bilateral* trade accounts are in balance. Country A (the United States?) has a bilateral surplus with country B (Venezuela?) and a bilateral deficit with country C (China?). Similar bilateral imbalances characterize the flows between the other two countries. The bilateral imbalances arise in this sim-

ple example because we have assumed differences in comparative advantage but similarities in tastes.

Macroeconomic Factors

Countries' trade flows and balances also are affected by the level of macroeconomic activity and relative prices.² Suppose one country is growing quickly and consuming a lot of imports while its trading partners languish in the doldrums of their business cycles and import only a little. The bilateral trade flows will be unbalanced so long as the two countries are at different points in their business cycles. Even when countries operate at full employment and full capacity utilization (referred to as "potential output"), bilateral imbalances could remain, for the reasons discussed above.

Another macroeconomic factor that will affect a country's overall and bilateral trade flows and balances is a change in the relative price between two countries' products (export price relative to price of competing goods abroad and import price relative to competing goods at home).³ Suppose that the home currency depreciates against the currency of a trading partner. All else unchanged, this depreciation would tend to make exports more price competitive in the destination market of the trading partner, and import-competing goods more price competitive against the products purchased from the trading partner. Exports to that partner would tend to rise, imports from that partner would tend to fall, and the bilateral balance would tend toward a surplus. However, only if the home currency depreciation were against the currencies of all the trading partners would the overall trade account tend toward surplus.

A third macroeconomic explanation depends on demographics. Over an individual's stylized life cycle, there is first birth; second, a period of earning, saving, and buildup of wealth; and finally, a period of retirement during which consumption draws on the portfolio of wealth. A similar theory based on demographics has been constructed for countries, one version of which is called the "intertemporal balance of payments" theory. A country with a working but aging population and a low birthrate and low immigration rate (Japan, for example) might reasonably be expected to have a high savings rate that yields a buildup of domestic and international assets that provides consumption to the population after the bulk of it retires. By this reasoning, a persistent trade surplus for an aging country could make sense.⁴

2. Chapter 8 provides a full discussion of this model and how it pertains to the US external imbalance.

3. For a more detailed look at how exchange rate changes pass through to change relative prices, see figure 7.1.

4. See Mankiw (1997, 420-25) for a presentation of the life-cycle model, and Obstfeld and Rogoff (1995) for a more specific presentation of the intertemporal theory of the balance of payments.

However, fallacies of the life-cycle model for the individual are compounded when the model is adapted to the country: How likely is it that a country will have no more-efficient workers (which is like having new workers)? And how likely is it that the population will all retire simultaneously? Hence, while these theories may help to explain a persistent global trade imbalance, they are not a reasonable first step for understanding bilateral imbalances.

These examples of comparative advantage and macroeconomic determinants suggest that there are many forces underlying both bilateral and overall trade patterns and balances. Separating out the particular effect of unfair trade policies would be quite difficult.

Characteristics of US Bilateral Deficits

An examination of several bilateral deficits of the United States shows that some are related exclusively to endowments and tastes, some to levels of development, some to cycles of economic activity—and some are hard to explain using these models. The US bilateral balances with most industrial-country trading partners mimic the behavior of the overall trade balance, suggesting that relative growth rates and relative prices have the key roles in driving these bilateral trade balances. In the US bilateral balances with major developing-country trading partners, in contrast, differences in comparative advantage based on stage of development as well as structural or policy factors such as trade barriers and exchange-rate management may be more important.

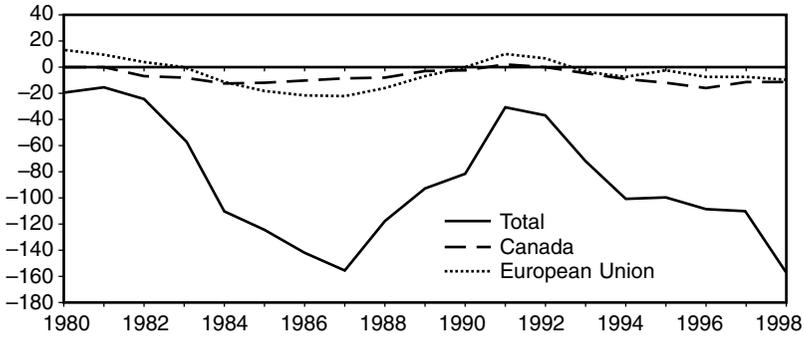
Canada and the European Union (EU) are broadly similar to the United States in terms of level of industrialization, resources, and, to some extent, tastes. The US bilateral balances for goods and services with Canada and the EU behave similarly to the overall US trade deficit (figure 6.2a). These bilateral balances widen when US growth is relatively stronger than growth in these trading partners. Exchange rate fluctuations also have an important effect on the US balance with the EU.

On the other hand, China as well as the Philippines, Thailand, Malaysia, and Indonesia (which, with others, collectively comprise the “Other Asia” category in figure 6.2b) are dissimilar from the United States in level of development and in tastes as well as in the types of products that can be profitably produced there. Following the simple three-country example above, we should expect US bilateral trade with these countries and regions to be unbalanced, with US imports from the region exceeding exports by a persistent amount. Indeed, we observe this in the data.

However, a notable feature of the data on the US trade balance with the Asian newly industrialized economies (NIEs)—Hong Kong, Singapore, South Korea, and Taiwan—is that the pattern is similar not to that of the

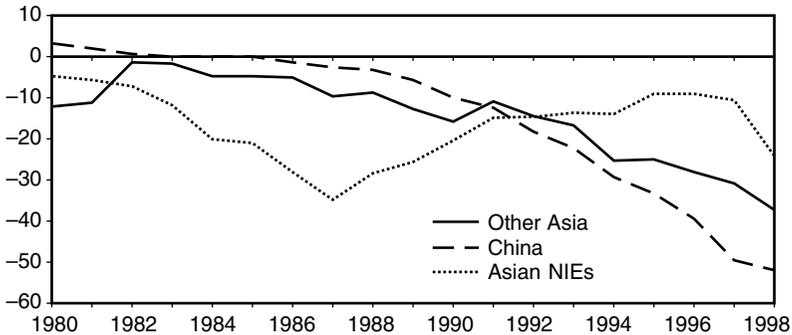
A. US bilateral balance on goods and services

billions of US dollars



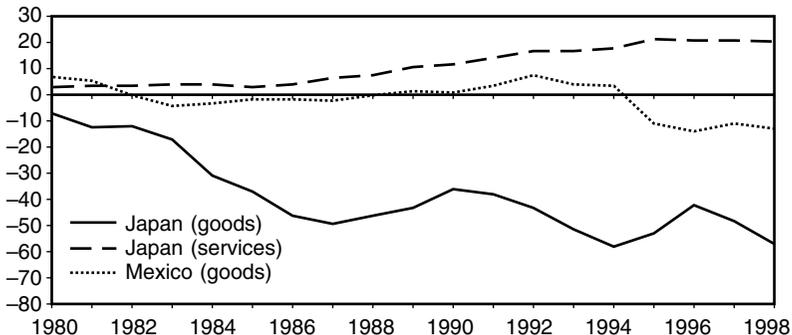
B. US bilateral balance on goods

billions of US dollars



C. US bilateral balance with Japan and Mexico

billions of US dollars



NIEs = newly industrialized economies

Note: The "European Union" category includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom. The "Other Asia" category covers Asia excluding Japan, China, and the Asian NIEs.

The trade balances for services for China, the NIEs, the "Other Asia" category, and Mexico are not available.

Source: US Department of Commerce, *International Transactions Tables*.

United States with China and the “Other Asia” countries but to that of the United States with Canada and the EU.

In 1980 the Asian NIEs were classified as developing economies by most measures. Now, on the basis of per capita income, all four are comfortably within the OECD range, and two rank well above the OECD average. These countries exemplify the argument that a movement along the path of economic development erodes the persistent trade imbalances with the United States. As the Asian NIEs developed, their comparative advantage changed (with much production moving to China) and their consumers’ demand for the sophisticated products and services of the United States increased. For both reasons, their trade deficits with the United States narrowed (and the US deficit with China increased). The speed with which this transition has taken place in these Asian economies is remarkable. While the financial turmoil and exchange rate changes of 1997 and 1998 affected US trade with the region and the purchasing power of Asian incomes, this development path (and pattern of trade) is assured and will be resumed.

In addition to the bilateral imbalance with China, two other bilateral US imbalances receive much attention—those with Mexico and Japan (figure 6.2c). In the case of Mexico, the rapid and significant change in both relative prices and income growth associated with the collapse of the peso and the aftermath (1994-95) have had the effect of widening the bilateral deficit. Before that, however, the pattern of US trade with Mexico was more similar to its pattern of trade with Europe and Canada than with China. This is due in part to the integration of Mexico into the production strategy of US firms, which was greatly enhanced by the North American Free Trade Agreement (NAFTA). When Mexico produces goods for the US marketplace, it uses inputs from the United States. Hence Mexico’s imports from the United States rise in tandem with its exports to the United States. On the other hand, as growth in Mexico strengthens, the US bilateral deficit should shrink as more US products are exported to satisfy domestic demand in Mexico. NAFTA negotiations have reduced the barriers facing US exports to the domestic Mexican market, so changes in the pattern of trade based on business cycles should become more apparent.

Japan is a somewhat different case, exhibiting both cyclical and structural characteristics. The difference in income growth rates has been a key factor in the dynamics of the bilateral balance, and exchange rate movements also have been important. In particular, the slow growth of the Japanese economy since 1991 has surely reduced demand for US goods and services. Yet, even though Japan has grown slowly, the US services surplus has increased steadily because US exporters of services are more competitive than the domestic providers in Japan.⁵ However, structural factors likely underlie the persistently negative merchandise trade deficit,

5. See chapter 3 for a discussion of service-sector competitiveness, and chapter 7 for a discussion of the role of competitiveness more generally in affecting the overall trade balance.

which is difficult to explain and has been the focus of much research (Bergsten and Noland 1993, 59-97).

Bilateral Trade Negotiations, Bilateral Deficits, the Overall US Deficit, and the Question of Sustainability

Just because macroeconomic forces and comparative advantage are important does not mean that trade policies have no effect on bilateral balances. Japan, perhaps more than any other country, has been much studied for whether its trading patterns evidence policy or institutional discrimination against certain types of products. Such policies or institutions might have a particularly negative impact on US exports. The composition of the US bilateral deficit with Japan does appear peculiar, since it is concentrated in autos and, to a lesser extent, computers and electronics products, and it seems relatively unaffected by the cycle underpinning the overall deficit (figure 6.3). The National Trade Estimate Report on Foreign Trade Barriers consistently devotes more pages to Japan than to any other country.⁶ The United States has initiated numerous and extensive bilateral negotiations with Japan to “open up” its markets.⁷ Some evidence suggests that this persistence has paid off, in terms of relatively faster growth of US exports in the targeted sectors.⁸ In more recent years, the very rapid increase in the US bilateral deficit with China has also been the object of much analysis, outrage, and negotiation.⁹

However, the question in this section is not whether bilateral trade negotiations can open up particular markets and lead to greater US exports, nor even whether such trade policy initiatives can alter the magnitude of a bilateral balance. Undoubtedly such negotiations can achieve

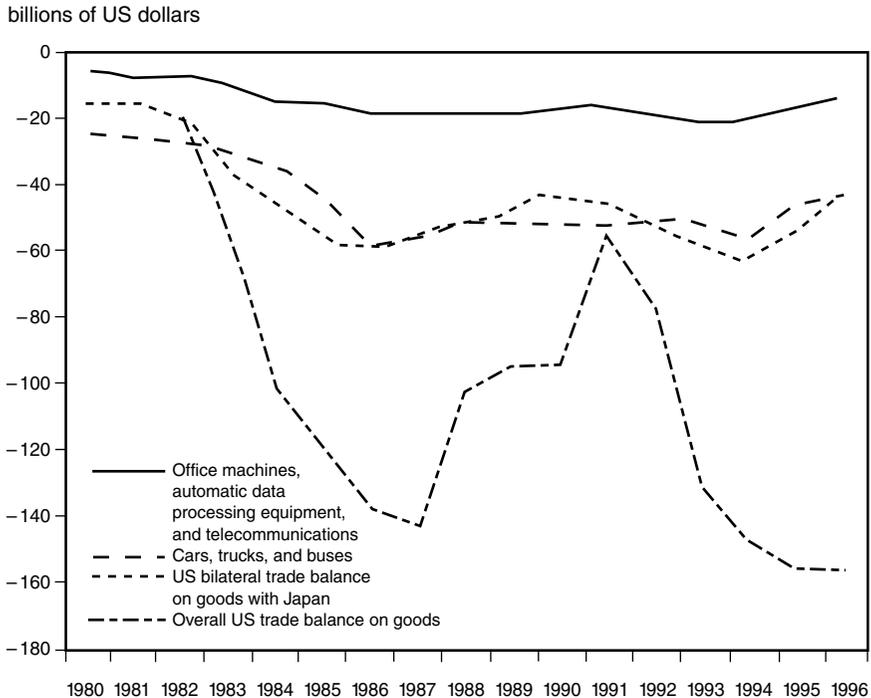
6. Congress established the annual National Trade Estimate Report on Foreign Trade Barriers in 1984 in order to help prioritize the administration’s trade negotiations. The Office of the US Trade Representative must identify significant foreign trade barriers, dollar value of lost trade, efforts to eliminate the barriers, and US priorities to expand export markets. (See also Bayard and Elliott 1994, p. 28, box 2.1.)

7. The focus of these negotiations has included agricultural products, ranging from apples and beef to fish and wood products; manufactured goods, in the sectors of automobiles and auto parts, semiconductors, supercomputers, and telecommunications equipment as well as flat glass and amorphous materials; and the services sectors, such as construction, financial services, and insurance.

8. Council of Economic Advisers, *Economic Report of the President*, 1996, p. 246, chart 8.1.

9. Several researchers focus on the issue of how large the US-China deficit really is, particularly since the Chinese and US accounts treat trade between the United States and Hong Kong in different ways. See, for example, Feenstra et al. (1998). Negotiations have been conducted on specific sectors, such as intellectual property, as well as very broadly, in the context of Chinese accession to the World Trade Organization.

Figure 6.3 Composition of US-Japan bilateral deficit, 1980-96



Source: Statistics Canada, *World Trade Analyzer*; US Department of Commerce, *US International Trade Goods and Services*.

those goals. The question here is, Can bilateral negotiations reduce the *overall* trade deficit and thus contribute to sustainability? To answer this, we return to the macroeconomic framework of chapter 2. A net export deficit develops when national savings are insufficient to finance domestic investment. Consequently, to affect the trade balance, bilateral trade negotiations must affect one or the other of these variables or their components. For example, a bilateral market-opening negotiation could affect external balance if it changed the national savings rate, say, by increasing business net profitability or by raising the household savings rate.

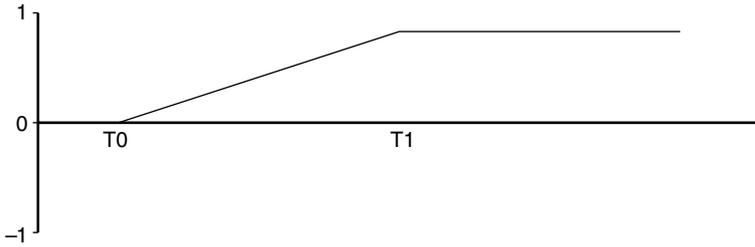
But how can an increase in the *level* of exports to a particular market affect the national savings *rate*? Figure 6.4 is a schematic of the relationships among the variables. Suppose market-access negotiations successfully raise US exports to a large trading partner (figure 6.4a), such as Japan or China.¹⁰ If the exporting firms exhibit economies of scale, the

10. Indeed, Bergsten and Noland (1993) suggest that such efforts could cut \$9 billion to \$18 billion from the 1990 levels of the US bilateral deficit with Japan. The gain to the United States from China's accession to the WTO under the deal as proposed in May 1999 would be \$3 billion (Rosen 1999).

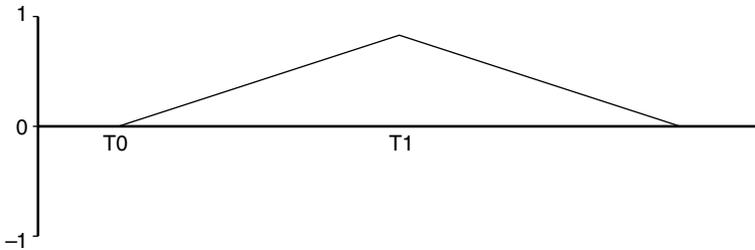
Figure 6.4 Market-opening trade policy and trade balance

T0: Market-opening policy implemented
T1: Normal spending behavior resumes

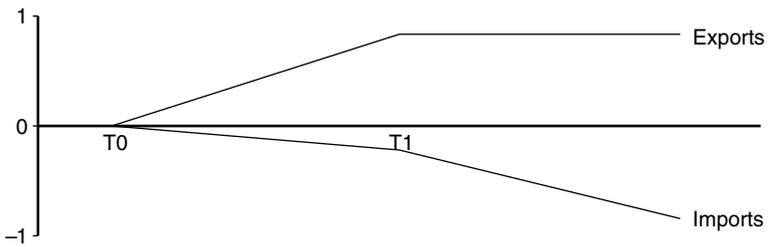
A. Target market exports



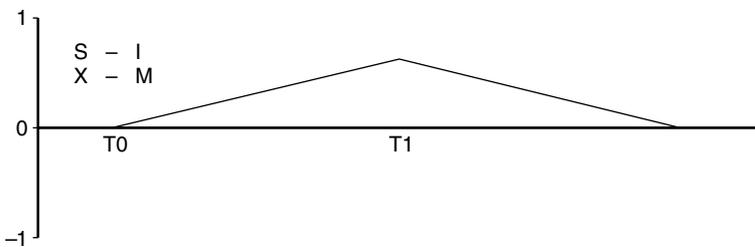
B. Business plus household savings rate



C. Overall exports and imports



D. Overall balances



increased sales will reduce costs and contribute to increased corporate profits. If these firms hire workers who previously were unemployed and who now work and save, the increased export sales will increase household savings. If the increase in private-sector profits and workers' savings *are not spent*, the economywide savings rate will increase. Consequently, the savings-investment balance will change, and both the bilateral and the global US external balances will improve. By this logic a targeted market-opening policy could improve not only a bilateral balance but the overall balance as well.

Why, however, should firms enjoying higher sales from newly achieved access to the export market not use those profits in the same way that they use profits generated from any other increase in sales? And why should the newly hired workers be more frugal than their already working colleagues? The firms will still need to purchase inputs, some of which will be imports. In addition, they may decide to invest in new plant or technology to support the increase in sales. Hence even if business profitability might rise initially, it will ultimately return to a normal rate of profit. The newly hired workers may pay off some debts (which raises the rate of household savings), but ultimately they will return to their normal consumption path (figure 6.4b), and some of what they consume will be imported goods. Market-opening trade policies increase exports, which, if everything else remains unchanged, will increase income, and imports rise along with income. *At the end of the adjustment* to the new bilateral trade regime, exports, income, savings, investment, and imports all will be greater, but internal and external balance will have returned to their original positions (figure 6.4c,d).

Hence market-opening bilateral trade negotiations will have salutary effects on many economic variables that policymakers care about, such as exports, jobs, and income. But such policies will not narrow the trade imbalance by nearly as much as some might think, particularly after adjustment to the export gain has taken place. A simple correlation of exports and imports bears this out: Controlling for changes in US GDP growth, an increase by \$1 in exports raises imports by \$0.60.¹¹

While “unfair” trade policies that *close* certain markets to US exports do contribute to US bilateral deficits, they are not a significant cause of the large—and particularly not of the increasing—US external deficit. This is all the more obvious given the *opening* of markets abroad through the reduction in trade barriers around the world during the 1980s and 1990s as part of the Uruguay Round of the General Agreement on Tariffs and Trade, on account of sectoral negotiations, and as a result of unilateral liberalization by some of our trading partners.

11. Since increased exports would raise GDP, and would raise imports, this calculation represents a lower bound on the relationship between export growth and import growth.

Multilateral Service-Sector Negotiations, the Overall US Trade Deficit, and the Question of Sustainability

Empirical analysis of the behavior of the US external balance suggests that there are systematic differences in the magnitude of the response of goods flows and services flows to changes in US and foreign income.¹² Decades of empirical work show that when US and foreign incomes rise, the tendency for the United States to spend the additional income on imports is about one and one-half to two times the tendency of other countries to spend their additional income on US exports. Therefore, if US and foreign incomes grow at the same rate, the US trade balance tends to worsen.

However, this asymmetry in responsiveness of trade to changes in income is reversed for trade in services (see table 8.2). That is, the tendency of the United States to purchase service imports is less than the tendency of foreigners to purchase US service exports when income rises. This makes sense; the United States enjoys global comparative advantage in the services sector and has a trade surplus in services.

In 1998, services constituted about one-third of US exports of goods and services and about one-sixth of US imports of goods and services; and the export share was rising faster. Over time, as the share of services in total US trade increases, the asymmetry as measured by the responsiveness of total trade to changes in income could disappear. Also over time, as other countries develop and demand more imports of services, the US surplus in services trade is likely to expand.

Why would multilateral service-sector negotiations affect the savings-investment balance differently than the bilateral market-opening negotiations highlighted in the previous section? First, as a multilateral effort, the impact on US firms and workers would be broader. As noted, service exports constituted 30 percent of US total real exports in 1998, 55 percent of corporate profits, 75 percent of US real GDP, and 80 percent of non-agricultural payroll employment. No bilateral market-opening negotiation will affect this share of US exports, or this share of the US economy. For example, one of the most hard-fought market-opening negotiations was the US-Japan agreement on autos and auto parts. In 1997 these sectors accounted for 6 percent of US total exports and less than half that as a share of real GDP. Consequently, the impact of multilateral service-sector negotiations on the US economy is simply much greater and much more broad-based. An increase in private savings (corporate and household) is more likely to accrue and be retained.

Finally, the globalization of production in the goods sector (which accounts for the fact that every dollar of exports is associated with \$0.60 of

12. For more details on the income and relative price framework for analyzing trade, see chapter 8.

imports, controlling for US real GDP growth) is far less pervasive in services. Service establishments often do locate abroad to be close to the customer, and service-sector negotiations will facilitate this movement. But when exported from a base in the United States, services are less import intensive than goods are. Consequently, service-sector negotiations will have a disproportionate impact on exports and a less-than-proportionate impact on imports.

Trade in services therefore should be a focal point for US negotiators in the next round of trade negotiations. The Uruguay Round began the process of liberalizing trade in services but left the majority of barriers in place (Hoekman 1995; Snape and Bosworth 1996). The objective for the year 2000 negotiations is further liberalization in key service sectors (Feketekuty 1998). Greater liberalization of service-sector trade in other countries would help narrow the overall deficit, and thus would contribute to making the US current account sustainable.

Trade Deficits and US Trade Policy Reaction

The 1980s: Aggressive Unilateralism

Worsening trade deficits, particularly bilateral deficits and deficits in particular industries, often precipitate demands for protection, for the opening of foreign markets, or for any policy initiative that might increase exports and/or reduce imports in the affected industries. This is precisely what we saw in the mid-1980s, when the US current account was headed toward a deficit amounting to 3.5 percent of GDP (\$185 billion). Legislation, voluntary export restraints, antidumping duties, threatened generalized import surcharges, and unilateral “results-oriented” policies all were part of the policy mix.¹³

The initial response to the widening trade deficit in 1981 was specific protection for autos and steel. The first broad legislative salvo followed in 1984 and focused on raising exports. One of the provisions of the Trade and Tariff Act of 1984 was to authorize the Office of the US Trade Representative (USTR) to initiate Section 301 trade cases itself, rather than to wait for an industry to bring a case. It was also this bill that required the USTR to produce the annual National Trade Estimates Report on Foreign Trade Barriers mentioned earlier.

Legislative attention then turned to imports. In 1985 Congress considered nearly 100 trade bills—almost four times the rate of the previous three years—that were protectionist in intent and that favored specific industries—autos, steel, machine tools, motorcycles (Bayard and Elliott

13. This section draws extensively from Bayard and Elliott (1994, 34-49), and the references cited therein. See also Destler (1995).

1994, 16). The same year, Senate Finance Committee Chairman Lloyd Bentsen (D-TX), House Ways and Means Committee Chairman Dan Rostenkowski (D-IL), and Representative Richard Gephardt (D-MO) introduced legislation that would have imposed a 25 percent tariff surcharge against countries with “excessive” trade surpluses.

Although the “Gephardt amendment” was (narrowly) rejected, the Omnibus Trade and Competitiveness Act of 1988 included the so-called Super 301 provision. This provision, which was authorized for 1989 and 1990, required that the president identify “priority” countries, as measured by number or pervasiveness of unfair trade practices. A program and timetable for negotiations on opening targeted sectors was required, and retaliation of some sort was a distinct possibility if negotiations failed to produce results.

The 1990s: The Same Brew?

The worsening of the US trade balance from the end of 1997 through the first quarter of 1999 rivals that of the 1980s. The merchandise trade deficit, the flash point for trade disputes, grew by \$50 billion in 1998 and added another \$6 billion in the first quarter of 1999 compared to the year earlier. Imports surged (as defined in table 6.1) in 28 product categories accounting for 15 percent of imports by value. The iron and steel categories accounted for 2 percent of total imports and 11 percent of the “surging” imports, so it is perhaps not surprising that this industry was first in line to demand protection.

In March 1999 the House of Representatives overwhelmingly passed legislation to put quotas on steel imports, though it was defeated in the Senate in June. Antidumping actions against steel imports were successful, and “voluntary” agreements to reduce steel imports were negotiated with some countries. Other bills in both House and Senate are being drafted to alter and strengthen the way in which existing Section 201 “safeguard” provisions can be applied to any industry facing a surge of imports. As the trade deficit widens, will the legislative agenda for 2000 come to look like that of 1985?

The legislative agenda likely will play out differently. First, \$23 billion of the 1998 deterioration in the merchandise trade balance was due to a widening of the imbalances of the countries immersed in the Asian financial crises. (This figure does not include Japan and China, where the shifts were about \$8 billion each for 1998.) Second, although the impact of imports on an industry are the same whether because of financial crisis or an appreciating dollar (as in 1985), industry reaction to surging imports this time has been tempered by the vibrant economic environment, with inflation, interest rates, and the unemployment rate at nearly half what they were in 1985, and profit rates nearly double.

Table 6.1 Import surges in 1998

	1998	1997	Growth rate	Share of total imports in 1997
	(millions of US dollars)		(percentage)	(percentage)
Total imports, census basis	913,828	870,671	5.0	100.0
Commercial vessels, other	77	24	220.8	0.0
Vessels, except scrap	4	2	100.0	0.0
Railway transportation equipment	2,059	1,251	64.6	0.1
Civilian aircraft	6,856	4,546	50.8	0.5
Other precious metals	3,930	2,643	48.7	0.3
Drilling and oilfield equipment	1,377	952	44.6	0.1
Cocoa beans	659	469	40.5	0.1
Laboratory testing instruments	1,649	1,288	28.0	0.1
Pharmaceutical prep	16,980	13,270	28.0	1.5
TVs, VCRs, etc.	13,361	10,546	26.7	1.2
Farming materials, livestock	766	609	25.8	0.1
Dairy products and eggs	893	711	25.6	0.0
Materials handling equipment	5,421	4,325	25.3	0.5
Excavating machinery	5,481	4,381	25.1	0.5
Engines—civilian aircraft	9,403	7,591	23.9	0.9
Shingles, wallboard	5,209	4,215	23.6	0.5
Stone, sand, cement, etc.	2,544	2,098	21.3	0.2
Iron and steel mill products	13,157	10,889	20.8	1.3
Parts—civilian aircraft	5,353	4,461	20.0	0.5
Vegetables	3,499	2,937	19.1	0.3
Furniture, household goods, etc.	9,732	8,269	17.7	0.9
Nonmonetary gold	3,603	3,072	17.3	0.4
Apparel, household goods—cotton	27,807	23,953	16.1	2.8
Motorcycles and parts	1,380	1,191	15.9	0.1
Records, tapes, and disks	1,136	982	15.7	0.1
Medicinal equipment	7,934	6,864	15.6	0.8
Iron and steel products, n.e.c.	4,112	3,560	15.5	0.4
Nonfarm tractors and parts	814	705	15.5	0.1

n.e.c. = not elsewhere classified

Note: Import surge is defined here as import growth rates at least three times greater than the average growth of imports for 1997-98.

Source: US Department of Commerce, *International Trade in Goods and Services*.

Another key difference underpinning any specific trade legislation is the stalemate on general trade policy, as evidenced by the failure of efforts to renew “fast-track” trade negotiating authority for the president after it expired in 1994. The sources of this stalemate and its effects on US trade policy and initiatives—specific and general, domestic and external—are beyond the scope of this book (see Destler 1995); suffice it to say here that the issue will be of great importance as the US economy likely slows into 2000 and the trade deficit widens further. The trajectory of the US deficit and its macroeconomic and political sustainability are discussed further in chapter 10.

Conclusion

Summary

- Bilateral imbalances are almost an inevitable outcome of different resource endowments, tastes, levels of development, and cycles of economic activity; a zero bilateral trade balance is a rare event.
- An examination of the behavior of US bilateral balances with countries and regions of the world supports the notion that the macroeconomic factors of differences in income growth and changes in relative prices are key drivers of many bilateral and certainly the overall trade balances. That said, some bilateral deficits are determined more by level of economic development, and a few arise from restrictions on exports from the United States.
- Bilateral trade negotiations can open particular markets, lead to greater US exports, and reduce a bilateral deficit. But is that negotiating effort well spent? Do such bilateral approaches affect the *overall* US trade deficit? To affect the overall balance, bilateral trade policy must work through the channels of savings and investment—for example, by changing business profitability or the household savings rate. Simply altering the level of exports into a particular market will do relatively little to change these savings rates; consequently, bilateral trade efforts generally will not significantly narrow the overall trade gap.
- Multilateral and broad-based initiatives to liberalize trade in services are more likely to improve the overall deficit. The United States has global comparative advantage in services, and services remain highly protected abroad. As economies grow, the share of services in consumption increases; with liberalization, their share in US exports would increase too. Statistical analysis suggests that, as income rises in foreign economies, they consume a relatively higher fraction of US exports of services than of US exports of goods. The sustainability of the

US external deficit would be enhanced by a growing share of services in US trade.

Policy Discussion

- A continually growing US external deficit will raise the volume of calls for protection. Sector-specific and bilaterally focused trade protection measures will clutter the domestic legislative agenda and poison the international negotiating waters. Explicit advocacy of a new multi-lateral round of fixed duration and with key sectors foremost on the agenda would create the greatest impetus for meaningful liberalization and the greatest likelihood of changing the overall trade balance.
- US negotiators should push beyond the standstill of the GATS in the Uruguay Round and offer more rapid access to markets in key sectors attractive to the developing countries (e.g., textiles, apparel, and agriculture) in return for meaningful service-sector liberalization. Pursuit of market-opening commitments in the service sector should also be a priority in regional negotiations.

