# Flash Economics

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# Why does the United States have such a large external deficit?

The Trump administration attributes the US external deficit either to the overvaluation of the dollar, due to its role as a reserve currency, or to protectionism by other countries.

But in reality, this external deficit has four origins:

- The de-industrialisation of the United States, which is a normal phenomenon given its comparative advantages ;
- The distortion of income in the United States to the detriment of wage earners, particularly low-income earners, who are forced to take on debt (hence the low household savings rate) in order to consume;
- The huge need for investment, particularly in new technologies, which exceeds the United States' savings capacity;
- The permanent public deficit (since 2000) in the United States.


**Patrick Artus**

**Senior Economic Advisor**

patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus



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## The extremely large US deficit

The US trade deficit (Chart 1A) or current account deficit (Chart 1B) is very large.

Chart 1A
United States: Trade balance in goods and services
(monthly data, USD bn)

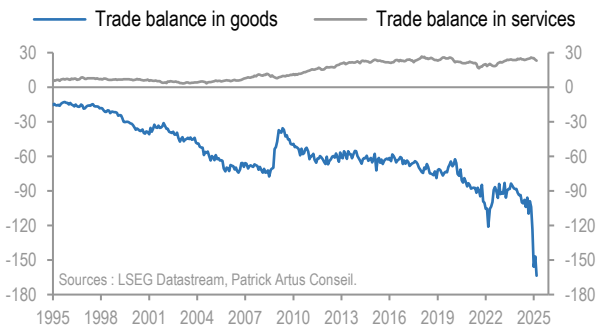
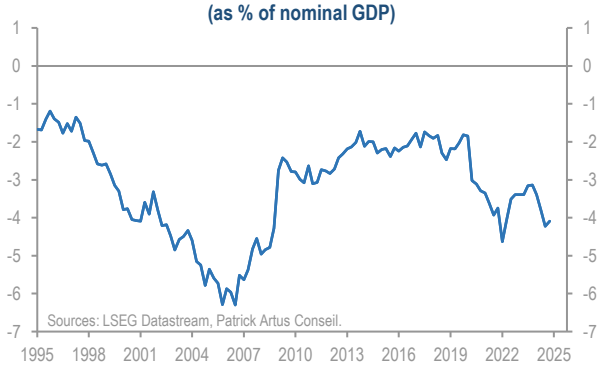



Chart 1B
United States: Current account balance
(as % of nominal GDP)



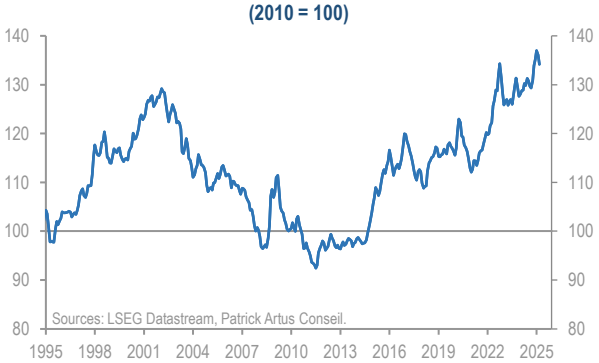

It is the growing trade deficit in goods, which is significantly larger than the trade surplus in services, that explains the overall trade deficit and the current account deficit.
The Trump administration attributes the US external deficit to:

- The overvalued dollar; or
- Protectionism by other countries.

## Explanations such as the dollar's overvaluation or protectionism by other countries are not convincing

Chart 2 shows the dollar's real effective exchange rate.

Chart 2
United States: Real effective exchange rate
(2010 = 100)

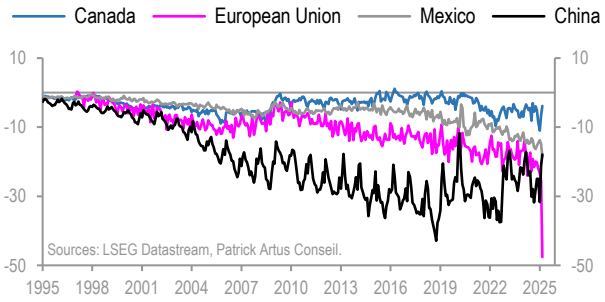



The dollar is indeed overvalued, but only from 2001 to 2003, and since 2022. On average, the dollar is not overvalued.

Furthermore, the explanation of protectionism by other countries does not hold water.

The United States has very large trade deficits with Mexico, Canada and the European Union (Chart 3), all countries with which it has free trade.

Chart 3
United States: Trade balance with Canada, Mexico, China and European Union (monthly data, USD bn)




## Four likely explanations for the widening US trade deficit

### 1. De-industrialisation, which is a normal phenomenon in the United States

**The share of manufacturing industry in GDP has been falling, especially since 2008** (**Charts 4A/B**), which is a normal development: the United States does not have a comparative advantage in producing mid-to-low-range industrial products; its comparative advantage lies in the production of technological and financial services. It is therefore normal that part of its industry has relocated to emerging countries (Mexico, China, **Chart 3**, above).

Chart 4A
United States: Real value added in manufacturing (as % of real GDP)

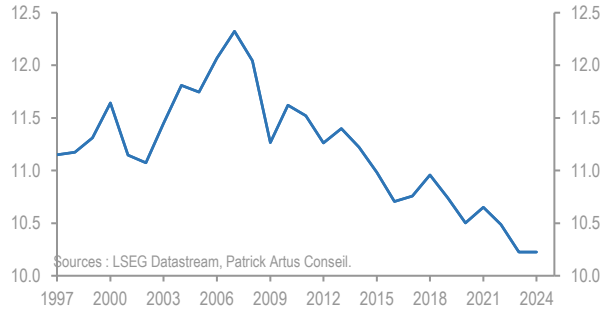


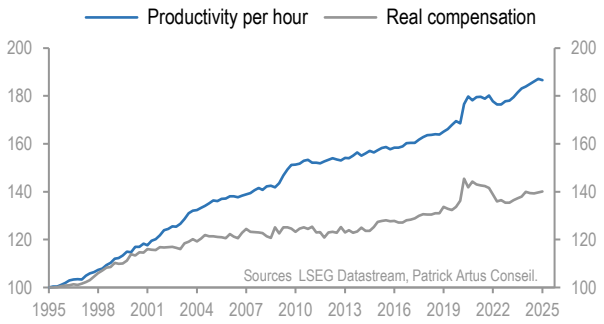

Chart 4B
United States: Real value added in manufacturing (as % of real GDP)




### 2. Income distribution unfavourable to wage earners, with consumption driven by debt (and therefore by the fall in the savings rate)

Income distribution has been very unfavourable to wage earners (very favourable to companies) in the United States since 2001 (**Chart 5**).

Chart 5
United States : Real compensation per hour and productivity per hour (business sector, 1995.Q1 = 100)




As a result, US workers **have had to support their consumption through debt** (**Chart 6**), **especially in the 2000s, and through the fall in the household savings rate, which has become very low** (**Chart 7**).

Chart 6
United States: Household debt (as % of nominal GDP)

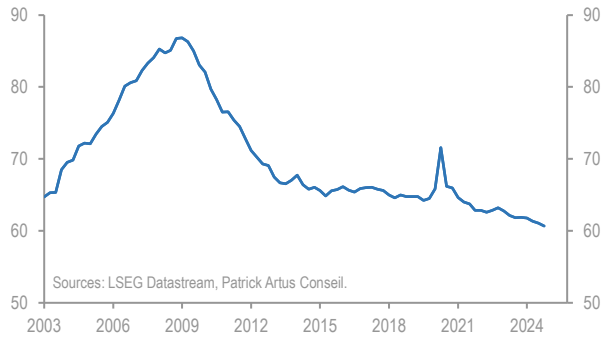
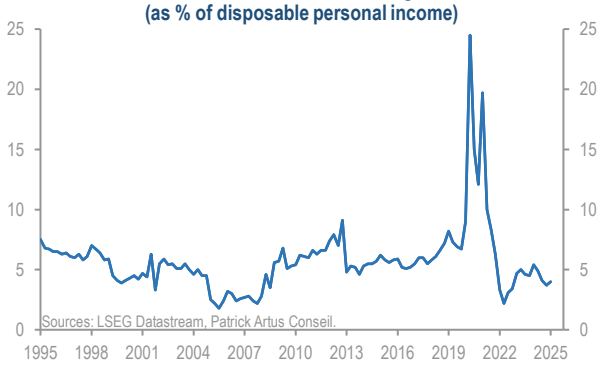



Chart 7
United States: Personal saving rate (as % of disposable personal income)




## 3. Very significant need for investment

The United States **has a high rate of investment, and in particular a high rate of investment in new technologies** (**Charts 8/9**).

Chart 8
Investment of corporations (in value terms, as % of nominal GDP)

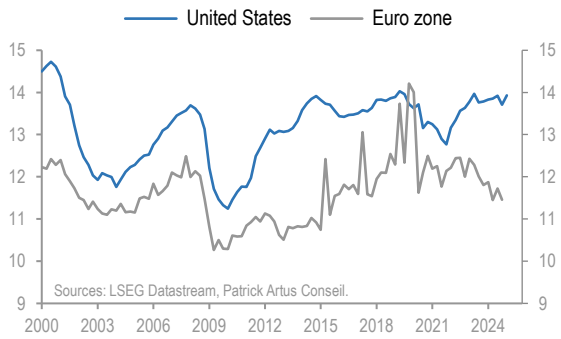
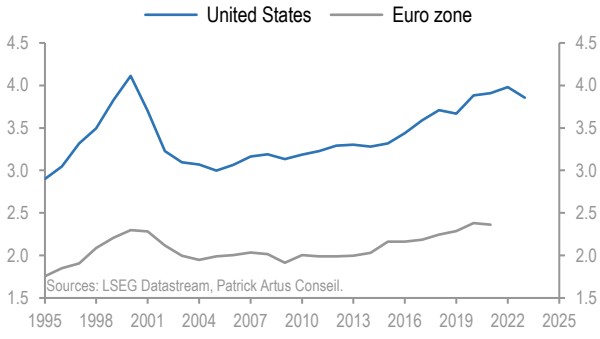



Chart 9
ICT investment including software (in value terms, as % of nominal GDP)

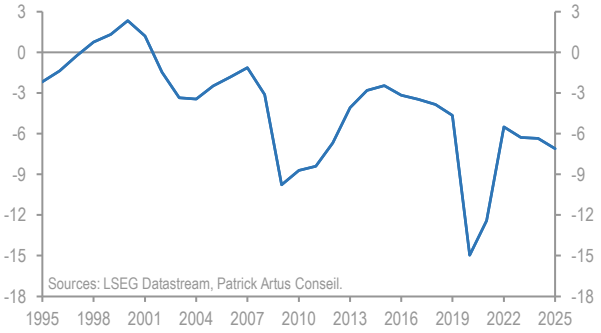



This level of investment cannot be financed by US domestic savings.

## 4. Public deficit

The final explanation for the presence of a permanent US external deficit is that the **public deficit**, which has been present since the early 2000s (**Chart 10**), reduces the nation's savings rate.

Chart 10
United States: Fiscal surplus or deficit
(as % of nominal GDP)

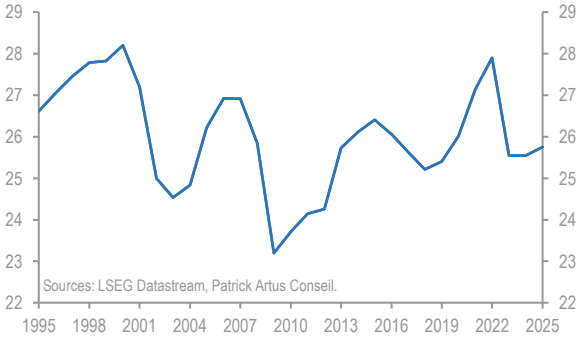



## Summary: what are the favourable or unfavourable causes of the United States' permanent external deficit?

The fact that the United States has a large permanent external deficit has a number of causes:

- Favourable to the US economy: productive specialisation in new technologies, high levels of investment and investment in new technologies;
- Unfavourable to the US economy: income distribution to the detriment of wage earners, which forces them to take on debt and save little; the permanent public deficit linked to the low tax rate (Chart 11).

Chart 11
United States: Tax burden (as % of nominal GDP)



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