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### GUEST EDITORIALS

# Foreign Trade & International Debt Report

## Update 2006

by Michael W. Hodges

[Grandfather Economic Report](#)

June 8, 2006

*Editor's Note: This update is a summary page from [Grandfather Economic Report](#). This is a mini-report about America's increasing dependence on international trade, its poor performance and reliance on savings from other nations instead of its own, causing accelerating debt and asset transfer in favor of foreign interests. Presented in an easy-to-understand format with data pictures, this report is a chapter of the [Grandfather Economic Reports](#) series showing various negative challenges facing families and their children, compared to prior generations.*

**QUESTION:** Do our children & grandchildren deserve to be placed in a reduced international position with less independence from foreign interests than we inherited from our parents and grandparents? Would that make us proud? Are their future living standards and national security threatened by an economy that is more dependent on domestic and foreign debt, consuming more than we produce and with fewer foreign reserves backing up each citizen than others?

- Since 1952 the **international reserve position of the U.S.** has fallen from 50% of the world's total to a 2.4% ratio - - a **95% drop**. The decline continues.
- Many other productive nations now have up to **23 times more** foreign reserves backing up each of their children than we have backing ours, and their lead is increasing as the U.S. continues with massive trade deficits and record high internal private sector debt ratios, with nil savings. With 5% of the world's population, America consumes over 20% of world imports.
- The U.S. is the **world's largest debtor**, a long fall from being the world's largest creditor when I was a young worker.
- For the past 30 years the U.S. increasingly has been unable to adequately compete internationally to balance its trade with the rest of the world to export sufficient goods to balance and pay for its imports. **Massive deficits soared**. Even the information technology sector is in deficit, and for the first time food imports exceeded exports.
- The U.S. economy is less independent than prior generations yet **one quarter of the economy depends on international trade** in goods, 3 times more than before - and foreign entities own more and more of our assets than we do theirs - while our [education quality](#) suffers relative to others.
- The merchandise import ratio has soared five times, from 3% of national income in the mid-1960s to today's 16% ratio - - while the export ratio has failed to improve despite numerous [devaluations of the dollar](#).
- As the U.S. **manufacturing base declined 60%** the economy realized significantly less capacity to produce goods needed domestically or desired internationally - - assisting import ratios to national income soaring 5 times.
- While the U.S. energy production base declined, energy consumption zoomed and the U.S. has

become more dependent on imported foreign oil and natural gas than ever before, as graphically shown in the [Energy Report](#). The **oil consumption-production gap is a whopping 71%**, as consumption soars and production and reserves continually decline. At the time of World War II the US produced all the oil it needed, even exporting to others. No longer.

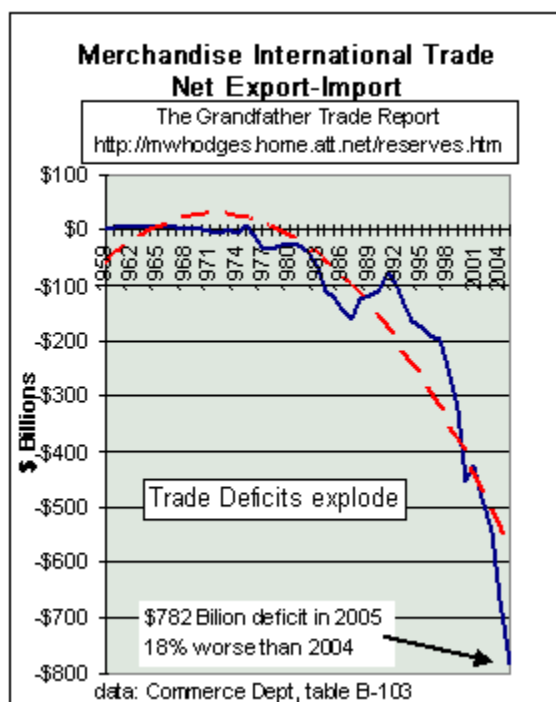
- For most of the 20th century the U.S. 'wrote' most of the rules for world trade. No longer.
- For a long time the U.S. dollar was unchallenged as the **world's reserve currency**. No Longer!

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- **Year 2005 trade performance produced a \$782 billion merchandise trade deficit, the largest negative trade balance in history.**
  - **Cumulative trade deficits since 1985 total \$5.7 Trillion** - - producing a **negative international net worth of \$5 Trillion.**
  - And, these trade deficits are owed to **non-Americans** - - not to ourselves.
  - Our annual international trade deficit is **35% larger than Social Security spending, 50% larger than all defense spending, and 2.5 times larger than Medicare.** This International Trade Report, together with the chapter called [America's Total Debt Report](#), proves we are living way beyond our means.
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For decades Americans enjoyed the game of consuming more than we produce, borrowing from the future to make-up the shortfall with unprecedented ratios of domestic and foreign debt increasing much faster than national income. These are dramatic facts, with significant long-term implications for the currency, international economic power, relative standard of living, and possible **national security** of our nation's children into the future.

**This lack of savings and over-borrowing from foreign interests cannot continue forever. The signal to free-up our economy from debt addiction is clear.**

## INTERNATIONAL TRADE - NEGATIVE TRENDS EXPLODING !!



This chart measures the U.S. merchandise (goods, excluding military) trade balance each year since 1959. It shows previously the USA ran a balance of trade, meaning we were able to sell enough goods to other nations to pay for what we purchased from them.

America **now runs massive deficits**. If a country runs a trade deficit it is **borrowing from the rest of the world so that it can spend in excess of its own production**. This means the USA is less competitive than before. **NOTE: The U.S. is setting record negative trade balances each year. Since 1992, deficits have exploded. Look at that trend!!**

This chart shows **2005 trade performance in goods was a \$782.1 billion trade deficit - - the largest negative trade balance in history**, 18% worse than prior year and 43% worse than 2003. Look at this chart again. **Dangerous trend!!!**

How can this record deficit continue in light of a falling exchange rate? The answer is an easy one > America's private and government sectors are increasing debts at a faster rate, much faster than incomes, causing more consumption and imports than could be supported by incomes and negligible savings. In

a nut-shell > **America is living beyond its means - - way, way beyond!!**

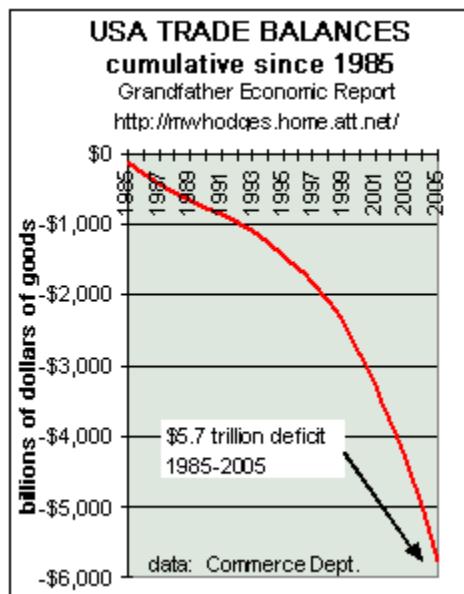
The **manufacturing base shrinkage** is a major negative regarding trade balance, and a major negative impact on U.S. economic independence and future living standards.

In the 12-months to **February 2006** the U.S. had a total merchandise trade **deficit of \$789 billion**, while **Japan & Germany** produced a cumulative **trade surplus** of \$283 billion (\$86+\$196). **That's a whopping \$1.07 trillion worse relative trade performance for the U.S.**, in JUST ONE YEAR. In 2001, for the first time, **China surpassed Japan** as the country with the largest trade gap with the United States. America's deficit with China surged 95% in the next 3 years, reaching \$202 billion and 27% of total US trade deficits in 2005.

This vividly shows how America is living beyond its means - - by consuming more goods made by others than it produces to meet the needs of foreigners - - resulting in **exploding debts in favor of foreigners, in addition to record high domestic debt ratios** of household, business and the domestic financial sectors.

It can be seen that the pattern since the mid 1970's brings into focus the basic question above - - America's **lack of competitiveness** world-wide - - increasingly so each year. **This indicates the U.S. has become less competitive**, despite claims of recent improved productivity (mostly realized only by a narrow part of the economy and primarily by revising how they measure productivity and inflation).

**USA CUMULATIVE TRADE DEFICITS—past 19 years**



The chart above showed the USA merchandise trade deficit for each year - - reaching an **all-time record deficit in 2005 of \$782 billion**.

The left chart shows the USA **cumulative** merchandise trade deficit - - with all nations since 1985. (cumulative means adding all deficits)

The cumulative merchandise goods trade deficit was **\$5.75 Trillion during the last 20 years** (since 1985). That means **each American man, woman and child effectively borrowed \$19,827 from producers in other nations**, because we Americans consumed more goods from other nations than we produced and sold abroad. As a result, foreigners now own nearly \$6 trillion more in US assets than in 1985.

Not shown on the chart is the cumulative goods trade deficit **since 1976 - - totaling \$6.12 trillion**. Prior to that period America produced near continuing surpluses with the rest of the world allowing America to own more assets in foreign nations

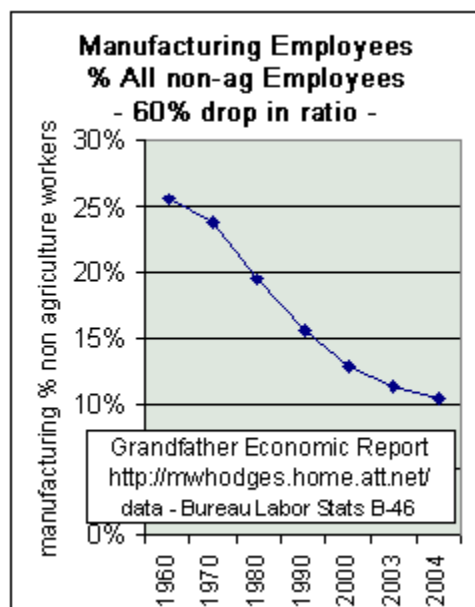
than they in ours. However, that net has eroded over recent years to an **accelerating negative net worth**.

Taking into account goods and services, and investment flows, which is called the current account - - "foreign-owned assets in the US totaled US\$9.4 trillion in 2001 while US claims on the rest of the world amounted to US\$7.2 trillion," according to the White House Council of Economic Advisers - - meaning a net \$2.2 trillion deficit with other nations as of 2001. Adding to this negative the combined current account deficits of \$1.64 trillion for 2002, 2003 and 2004 sums to nearly **negative \$4 trillion against the U.S. in favor of non-U.S. entities**. Not only is the technology product sector in deficit, but the U.S. Department of Agriculture Economic Research Service estimates 2005 will be the first year in nearly 50 that America will not turn an agricultural trade surplus.

**How can competitiveness be said to rise as the result of higher so-called "productivity" if at the**

**same time the trade deficit explodes? What competitiveness?"** It is clear that the so-called 'economic boom' of the 1990s was a false boom, because the economy was fueled primarily by increasing internal and foreign debt - - instead of by internal production, savings and competitiveness. **The above chart shows our growing lack of competitiveness as we increase foreign debt at a faster pace.** The long-term performance of our currency is our fault > negative trade balances fueled by massive domestic and international debts.

### MANUFACTURING BASE DECLINE



How can America ever export enough goods to other nations to balance its negative balance of trade of soaring imports if it has a declining manufacturing base?

The left **chart**, from the [Family Income Report](#) chapter about stagnant income growth, **shows** the trend of the number of **manufacturing workers** as a percentage of all U.S. employees (non-agriculture) - - from 26% in 1960 to 10% in 2004, a **60% drop in the manufacturing ratio**.

On a **GDP basis** the trend is the same negative > the U.S. **manufacturing base declined** from 30.4% of GDP in 1953 (when we had a trade surplus) to 12.7% in 2003 - a **58% drop in the manufacturing share of GDP** - and more of the remaining manufacturing base is foreign-owned than before. (Bureau Economic Analysis table b-12, Economic Report of President, appendix table)

The number of manufacturing employees declined 17% from 2000 to 2004.

As America's manufacture of goods has become a much smaller share of the economy and of its work-force, the U.S. became 5 times more dependent on foreign imports - - consuming 16% of national income, up from but 3% in 1960s. The export ratio has not improved in 30 years, despite many [devaluations of the dollar](#).

Note the **down-sloping trend of this chart far pre-dates the opening of China as a major world manufacturer**.

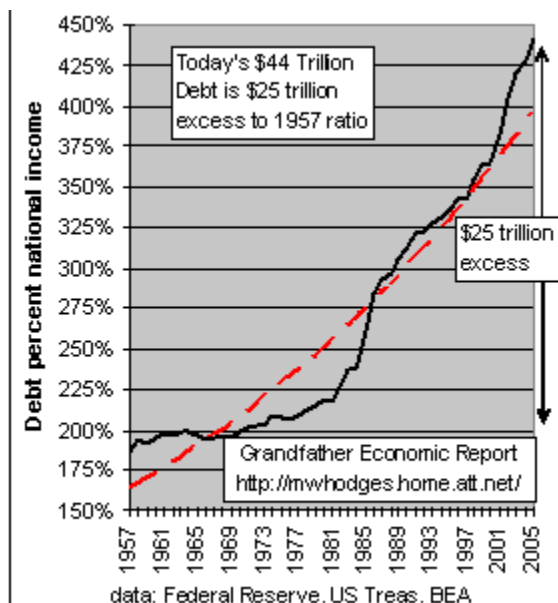
According to economist Steve Roach of Morgan Stanley (4/05), "the average Chinese **manufacturing worker** made 12,496 yuan in 2003, which translates into about US\$29 per week. By contrast, average weekly earnings of US manufacturing workers amounted to \$636 per week in 2003. With Chinese manufacturing wage levels only 4.5% of their US counterpart, it would take about 20 years of sustained 15% annualized Chinese wage inflation to close half the wage gap with the US. Don't kid yourself. Even with Chinese wage inflation, the economics of the labor arbitrage between the US and China remain compelling for as far as the eye can see." Of course Mr. Roach's statement assumes no inflation in the USA during the next 20 years, most unlikely considering [U.S. inflation history](#).

**Bottom-line** > manufacturing base shrinkage is a major negative regarding America's trade balance, economic independence and future living standards, including national security.

### DEBT-DRIVEN IMBALANCES



The chart at the top of this page showed America's trade deficits started soaring in the late 1970s to early 1980s. Today's deficits are increasing even faster.



Now look at the left chart, from the powerful chapter '[America's Total Debt Report](#).' It shows America's total debt (sum of all government debt and all private debt of households, business, and financial sectors) started to grow faster than growth of the economy's national income - - at about the same time (late 1970s to early 1980s) - - increasing even faster today.

What this says is that debt drives over-spending, over-consumption - - beyond incomes and savings. Therefore, excessive debt also drives imports - - faster and faster, driving soaring trade deficits.

This chart is a ratio chart - - a ratio of total debt in America to national income. If America's debt dependence were not growing faster than the economy during this period the chart's trend line would have remained horizontal. However, the debt ratio's trend line

is straight up in the past 25 years, which means debt increased each and every year faster than growth of the economy. Much of that debt was promoted by Federal Reserve interest rate and government tax policies - - including more rapid debt growth lately fueled by record low interest rates.

This 25+ year period of rapid debt growth (and rapid growth of trade deficits) was also a period of relatively stagnant inflation-adjusted median family income growth according to the [Family Income Report](#) chapter. That chapter also reports very strong income growth in the earlier period of this chart when debt ratios were not growing and when trade imports vs. exports were in balance.

**To say soaring trade deficits were greatly influenced by soaring internal debt generation, which drove consumption beyond incomes and personal savings, would be an under-statement, for sure.**

What are foreigners doing with that which we borrowed from them? Answer: they own increasing percentage of our businesses, stocks, bonds, real estate and [government treasury bonds](#). Meaning > > Americans own less and less of their nation.

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**Devaluing the U.S. dollar's foreign exchange rate will not solve the problem >** The [Foreign Exchange Report](#) chapter shows the U.S. dollar's exchange rate mostly declined during the above period of trade deficits and manufacturing base decline. Which, of course, tends to prove that forcing down the dollar's exchange rate is not an assured recipe to produce long-term trade surpluses or a rising manufacturing base.

And, **it is wrong to blame China's** wage rates and currency exchange for U.S. trade deficits and manufacturing decline, since Japan and Germany each have higher wage rates and a stronger currency yet realize a much larger trade surplus than does China. One thing for certain is that citizens of China, Germany and Japan have high rates of personal saving, whereas [U.S. savings are nil](#). They produce and save while Americans consume and increase debt instead of save.

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The above charts clearly show America's **soaring negative trade balances are certainly impacted by an economy structured more debt-dependent and less manufacturing-dependent and less savings-dependent than ever before.** While America can do nothing about Chinese labor rates or Germany's manufacturing expertise its leaders certainly can do a great deal to cease promoting debt-driven consumption subsidized and fueled by tax and low interest rate policy.

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## DOES IT MATTER—THESE DEFICITS??

- **June 2005**, Former Fed Chairman Paul Volcker said "he doesn't see how the U.S. can keep borrowing and consuming while letting foreign countries do all the producing. It's a recipe for American **economic disaster** - - a crisis is likely."
- Federal Reserve Chairman **Alan Greenspan** said, "We cannot depend on imported capital, that is, a current account deficit, to offset low domestic savings indefinitely."
- In its August 2001 annual assessment of the world's largest economy, the International Monetary Fund (IMF) said "the yawning current account deficit raised the **risk of a sharp depreciation in the U.S. currency.**"
- On July 2001 former Federal Reserve Chairman **Paul Volcker** told the Senate Banking Committee hearing on risks of growing balance of payment deficit, "We are a debtor nation with nil personal savings and are absorbing a significant portion of other countries savings. These huge and growing external deficits are symptoms of imbalances in the national economy and the world economy that **cannot be sustained.**"
- On 30 April 2001 White House Economic Advisor **Dr. Lawrence Lindsey** said, "We are in uncharted territory - - it's unprecedented - - it cannot go on - - something has to give."
- MIT professor **Dr. Lester Thurow** said, "No country can run a large trade deficit forever."
- The U.S. Trade Deficit Commission, December 2000, said, "Not only is the trade deficit not sustainable but it carries a great deal of danger to the nation and living standards."
- WASHINGTON, April 16, 2005 (Reuters) - **Global economic risks from large U.S. deficits** and uneven growth and saving rates are clearly increasing and **require urgent action**, International Monetary Fund chief Rodrigo Rato said.
- *"Growing domestic and international debt has created the conditions for **global economic and financial crises.**"* Bank for International Settlements, June 2005.
- Foreigners now own more and more of America - - about \$9 trillion of U.S. financial assets, including 13% of all stocks, 13% of agencies, and 27% of corporate bonds, according to Gillespie Research. According to the [Federal Government Debt Report](#) they also own 46% of Treasury bonds & bills. Additionally, they own real estate and factories.
- There are zillions of items upon which America depends on foreigners to supply. Most know America is dependent on foreigners for 60% of its oil, much medical equipment, an increasing portion of automobiles, and most of the stuff sold by Wal-Mart. However, few know **America is even 100% dependent on foreigners (British and French) for flu vaccines needed by senior citizens.** A nation that will not even produce its own flu vaccines is not a very smart nation.
- **Americans should not be mad at foreign interests**, hoping somehow they will change to accommodate our debt-driven consumption over production and nil savings. Americans are the ones consuming beyond our own production, creating unprecedented debts and trade deficits PLUS excessive regulations and government spending at all levels - - with nil savings.

## WHAT TO DO?

It has been said that there are only **three ways in which negative trade balances can be restored:**  
 (1) the deficit-incurring country (USA) must cease excessive credit (debt) expansion which sucks in

imports faster than incomes warrant and allow interest rates to climb to reverse debt ratios, (2) other countries must inflate their economies to over-price their own production so as to suck up more U.S. exports, (3) the deficit country (USA) must allow its currency to depreciate to drive up prices.

**What's happening?** Answer (1) USA increases debt even faster (see [America's Total Debt Report](#)), while (2) crying for other countries to inflate away their currency and grow their imports from America, and (3) allowing depreciation of the US dollar (see [Foreign Exchange Report](#)), causing a loss of international buying power of every US wage earner and holder of dollars - to the tune of negative 40% against the Euro in recent years.

One **should not accept leaders hiding-out by calling for a 'level playing field', demanding (as if they have a right to demand) that all non-Americans change their nations** to also have huge, soaring debt ratios, near zero savings rates and a declining manufacturing base like America's, with U.S. [regulatory compliance cost](#) burden ratios, or even the number of U.S. [lawyers per capita](#). The US must clean its own house. These are covered in the full Trade Report - - link below.

**What should happen to those powers-to-be who promote and allow degradation of our currency, our international net worth, and foreign reserves per capita (the international buying power of its citizens) - - and what should happen to those who promote tax and interest rate policies which drive debt and consumption instead of production and savings - - or about those who make America's future living standards and national security more and more dependent and beholden to non-Americans?????**

**Is that the proper legacy to pass along to our children and grandchildren?** This author thinks NOT !!

The trends shown in the above charts (and those in the full report below) are most dramatic  
-- a threat to our economy, and potentially to [national security](#) --  
and -- a threat to our increasing [dependence on foreign-produced energy](#)

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**Web note:** This article was created from the summary page of the [Grandfather International Trade Report](#) chapter. In addition to this summary page with several graphics, it is recommended that the reader also visit the [Full Trade Report](#), which contains many more data graphics, fully telling the story of this important subject.

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