

Record US trade deficit highlights global imbalances

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The announcement of a record balance of trade deficit has once again thrown a spotlight on the deepening financial problems of the US as it prepares to unleash war against Iraq.

Figures released by the Commerce Department last week show that the deficit for 2002 was \$435.2 billion, up 21.5 percent from the \$358.3 billion trade gap in 2001 and easily surpassing the previous record of \$378.7 billion set in 2000. The December deficit of \$44.2 billion was also a record monthly high, up by more than 10 percent from the previous record of \$40 billion set in November.

According to the department's figures, the trade balance was hit from two sides. The goods deficit, reflecting trade in items such as motor vehicles, food and computers, increased to \$484.4 billion from \$427.2 billion while the surplus in services, including items such as tourism, royalties from films and financial services, fell from \$68.9 billion to \$49.1 billion. Overall exports of goods and services for 2002 fell by 2.5 per cent to \$973 billion, reflecting the slowdown in the world economy.

The growing US trade deficit and the emergence of rapidly increasing budget deficits were the subject of discussion at the meeting of the finance ministers of the Group of Seven held in Paris at the weekend. Both the head of the European Central Bank and the chairman of eurozone finance ministers warned that the Bush administration's \$690 billion tax cut plan could adversely impact on the world economy.

Nikos Christodoulakis, who chairs the group of eurozone finance ministers, said "twin deficits" could "create sustainability risks" which, if they materialised, "would have significant ramifications well beyond the US itself. The Bush tax cut plan "in terms of size, composition and timing" did not dissipate those

concerns, he said.

ECB president Wim Duisenberg was somewhat downbeat on the state of the world economy. "The prospect of an economic recovery to potential growth this year is not supported by the latest information," he said.

In a comment published on the eve of the meeting, the *Economist* said that while the fact it was being held was a sign that global economic co-operation among the world's major powers was still on the agenda, both the economic and political climates were "hostile". In spite of regular G-7 meetings, "international economic co-operation seems to have gone out of fashion."

The problems of the global economy, it pointed out, go beyond uncertainty over the consequences of US action against Iraq. US Federal Reserve Board chairman Alan Greenspan "recently worried aloud that the underlying weakness in the economy might be structural and not simply a response to geopolitical uncertainty."

Germany, it continued, was "teetering on the brink of recession" and may have even entered it, with its predicament being increasingly likened to that of Japan where the economy is facing its fourth recession in a decade.

"Economists," the article pointed out, "are increasingly concerned about the global imbalances which could undermine economic stability and growth." Chief among these is the American current account deficit, now running at about 5 percent of gross domestic product. The textbook solution to this problem is for a fall in the US dollar against other currencies leading to a boost in US exports. In line with this scenario the dollar has fallen about 10 percent on a trade-weighted basis from a year ago, and is down more than 20 percent from its high point against the euro at

the end of 2000.

But a fall in the US dollar, only throws up other contradictions in the world economy. Even more than a growth in exports resulting from a lower dollar, the US depends on a revival in the world economy to improve its position. However, a fall in the US dollar—increasing the value of the euro and the yen—will adversely affect Europe and Japan, both of which are relying on increased export demand to stave off recession.

The growth of imbalances within the world economy, resulting from the lack of overall growth, has been the subject of increasing comment. Morgan Stanley chief economist Stephen Roach contrasted the situation today, on the eve of a new war against Iraq, with that which prevailed at the time of the 1990-91 Gulf War. He noted that in the earlier period the world economy was being sustained by three areas: the US was averaging 3.4 percent growth, Japan 4.8 percent and Europe 3 percent, with East Asia averaging more than 8 percent growth. Over the seven-year period 1995-2002, however, the US accounted for some 64 percent of the cumulative increase in world GDP.

“Unfortunately, this one-engine world has spawned massive external imbalances; that’s underscored by America’s record 5 percent current-account deficit in 2002—and matched by Asia’s and, to a lesser extent, Europe’s current-account surpluses. In fact, never before has the modern-day world economy been saddled with such extraordinary disparities between outsize current-account deficits and surpluses.”

In two articles so far this year, *Financial Times* global economics columnist Martin Wolf has pointed to the “remarkable” fact that while it has the most powerful military, the biggest economy and the most important currency, the US is also running a “huge and growing current account deficit.”

By contrast he pointed out that in the lead-up to World War I, Britain ran current account surpluses of 4 percent of GDP. “Last year, however, its successor as world power ran a deficit close to 5 percent of GDP and had net external liabilities of 25 percent.” According to Wolf, economic calculations based on “highly plausible assumptions” show that the overall US current account deficit could rise to 9.5 percent of GDP by the year 2010 when net external liabilities would be close to two-thirds of GDP.

“The superpower,” he concluded in a comment

published on January 7, “is living on borrowed money and borrowed time. Its rake’s progress cannot continue for ever. But how and when it will end remains disturbingly obscure.”

Of course no one can say exactly how the deepening financial crisis of the US economy will develop. But one thing can be said with certainty: the US will increasingly seek to resolve its growing economic problems by military means at the expense of its rivals. This is the significance of the war drive against Iraq and the bitter conflict it has provoked with some of the European powers.



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