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From the Private Secretary 16 April, 1984

The Prime Minister has asked me to thank you warmly for your letter of 5 April and the speech which you enclosed on "The American Trade Deficit in Perspective". Mrs. Thatcher has commented that your speech applies your customary clarity and wisdom to the enormous issues that face us.

The Prime Minister sends you every good wish.

A. J. COLES

His Excellency Mr. Arthur F. Burns.

EMBASSY OF THE
UNITED STATES OF AMERICA

Bonn, Germany
April 5, 1984

Dear Madam Prime Minister

I am enclosing a recent speech of mine that deals with economic issues that have excited interest in Europe as well as the United States.

With kind regards.

Sincerely,

Arthur F. Burns

The Right Honorable Margaret Thatcher
Prime Minister
London, England

THE AMERICAN TRADE DEFICIT IN PERSPECTIVE

Arthur F. Burns

Ambassador of the United States

to the Federal Republic of Germany

Presented at

The Industrie Club

Duesseldorf, Federal Republic of Germany

April 5, 1984

THE AMERICAN TRADE DEFICIT IN PERSPECTIVE

by

Arthur F. Burns

I very much appreciate the opportunity to address this distinguished audience today. The topic I have chosen to discuss with you is the merchandise trade of the United States with other countries. My reasons for focusing on this subject are not parochial. In the first place, it is important for Europeans to understand that the strong recovery in America's over-all production and employment has been accompanied by further deterioration in its foreign trade. Secondly, the poor trade performance of the United States in recent years reflects a disequilibrium in the world economy as well as in our domestic economy. Widespread political strains have been the inevitable result. The promises of last year's Williamsburg Summit with regard to international trade and finance have not been fulfilled. If anything, international tensions arising from economic issues have increased during the past year.

Let me begin by reciting some of the essential facts about the foreign trade of the United States. Until 1970, my country enjoyed a surplus in its merchandise trade with the rest of the world. Since then, with oil prices higher and competition from our trading partners keener, trade deficits have been the rule. For a time this served a constructive international role in view of America's surplus on other items in its international accounts. But the trade deficit took a quantum jump towards the end of the 1970's when it reached a rate of about 30 billion dollars per year--a rate that was maintained through the first half of 1982. More recently, the trade deficit has grown by leaps and bounds. It reached an annual rate of 75 billion dollars in the final quarter of 1983, and is expected to exceed 100 billion dollars this calendar year.

To be sure, the deterioration in America's merchandise trade is still being offset by our traditional surplus on trade in services and on investment income from abroad. Even so, the deficit in our international current account--which allows for these items--reached over 40 billion dollars during 1983, and ran at a much higher annual rate in its final quarter. The counterpart of this

dramatic current account deficit has been a huge flow of funds from abroad to the United States combined with a sharp contraction in our traditional capital exports. That is hardly a welcome development for a nation with the largest and richest economy in the world.

There is a widespread belief in American circles that many of our industries can no longer compete against more efficient Japanese firms. There is worry as well that American producers are being victimized by unfair competition from low-wage producers in developing countries and subsidized products of European and other foreign enterprises. Such explanations of our foreign trade deficit contain an element of truth, but hardly more than that. The principal causes of America's recent trade deterioration are to be found elsewhere--in the high value of the dollar in foreign exchange markets, in the faster rebound from recession in the United States than in Western Europe or Japan, and in the unavoidable need of debt-ridden developing countries to practice austerity.

The strength of the dollar in foreign exchange markets in the past few years is well known in Europe. Between late 1980 and early this year the dollar appreciated about 30 per cent against the Swiss franc, 40

per cent against the British pound, 50 per cent against the German mark, 100 per cent against the French franc. The dollar's appreciation against the Japanese yen and Canadian currency was much less. Nevertheless, taking the currencies of the ten major industrial countries together, the dollar appreciated on the average about 50 per cent during that period. The high cost of the dollar obviously has made American goods less attractive to foreign buyers, while the low cost of foreign currencies has made foreign products more attractive to Americans. Although the dollar has weakened since the start of this year, it still retains the greater part of the appreciation against other currencies that occurred after 1980.

Another major cause of America's trade deterioration is the difficulty that many developing countries have been experiencing during the past two to three years in borrowing abroad. By 1982 an increasing number of commercial bankers and other suppliers of credit finally realized that they had been less than prudent in accommodating--in fact, often even encouraging--the eagerness of developing countries to pile up indebtedness. Once lending to these countries was curtailed, one after another of them found it impossible

to meet its scheduled debt repayments or even the interest due on its indebtedness. To prevent outright bankruptcy, their governments had to plead for financial assistance from the International Monetary Fund, other governments, and the private financial community; but such help could not remove the need to practice austerity--particularly, to cut imports and expand exports. The nations of Latin America, which have especially close commercial ties with the United States, were foremost among those suffering a shortage of foreign exchange. Not surprisingly, the dollar value of our exports to Latin America was cut almost in half between the first quarter of 1981 and the final quarter of 1983.

A third factor in America's trade deterioration is the uneven cyclical development of the major industrialized countries. Economic recovery began in the United States towards the end of 1982 and gathered momentum rapidly. The economy of Canada recovered about the same time and advanced almost as rapidly. Other industrial countries did not do as well. Japan's economy continued to advance but at a diminished rate. Great Britain and Germany recovered more gradually than the United States, while the rest of Western Europe continued

to experience stagnation or recession. Because of the lag of the recovery process outside the United States, our exports to Europe and Japan became very sluggish while our imports soared--as always happens during the expansion phase of the business cycle.

In addition to the several major causes of America's trade deficit on which I have dwelt--namely, the strong dollar, the distress of developing countries, and the rapid rebound of the American economy--a host of other factors played some part. Two of them deserve special mention: first, the world-wide drop in oil demand which forced OPEC members to cut back their imports; second, recent developments in world agriculture--a subject to which I will need to return--which also contributed to the deterioration of America's foreign trade.

The piling up of these unfavorable trade developments has become a matter of widespread concern in the United States. Farm income was already depressed during the late 1970's; and with foreign sales declining, it has plummeted since 1980. Moreover, the shrinkage in exports of our manufactured products resulted in a reduction of both jobs and profits in numerous firms--particularly those engaged in producing machinery,

civil aircraft, and other capital goods. Meanwhile, the rise in imports kept adding to the displacement of workers involved in the manufacture of various consumer as well as capital goods.

Professional economists often look upon such vicissitudes of trade as normal workings of a competitive market, and they are apt to express confidence that the difficulties will eventually be corrected through the marketplace. In principle, there is considerable justification for such views.

As the economy of the United States continues to expand, its rate of expansion is bound to moderate. Meanwhile, signs of economic recovery in Western Europe, which have been gradually reemerging, are likely to multiply. With the gap in economic performance between Europe and the United States narrowing, America's trade deficit will tend to diminish. On balance, Latin American developments should also be less damaging to our foreign trade. During the past year, the heavily indebted countries of Latin America have experienced significant improvement in their current account balances with the rest of the world. Hence, the recent sharp reduction in their imports from the United States can hardly be

expected to become still larger. Moreover, since the purchasing power of the dollar over commodities appears to be appreciably overvalued relative to other currencies, it would not be at all surprising if the decline in the foreign exchange value of the dollar that has occurred since its January peak were moderately extended over the next year or two. In short, one can reasonably argue that the marketplace is already releasing forces that before long will diminish the American trade deficit.

Relaxed thinking along these lines, however, is rarely shared by American businessmen, farmers, and workers who happen to have been adversely affected through foreign trade. Nor is it shared by politicians -- particularly in an election year. Of late, American advocates of restrictive trade policies have become bolder, and their complaints about trade practices of other countries have become more strident. Their calls for new import barriers are being echoed by similar calls in Europe. After all, numerous European industries have also experienced an economic setback in recent years, and unemployment is now extensive throughout Western Europe. With the virus of protectionist sentiment spreading, the need for economic statesmanship both in the United States and in Europe has become urgent.

America's foreign trade problem is also Europe's problem, and it is important for both Europeans and Americans to try to see from an international viewpoint the trade and financial issues that have caused political tensions among us. In the process of doing that, we are all bound to find that what Americans regard as their special problem involves common international concerns that require better mutual understanding--and often also corrective measures--on both sides of the Atlantic.

One of the problems that has been especially troublesome in the relations between the United States and Western Europe involves agricultural trade. Americans have long complained about the protectionist thrust of the European Community's agricultural policy--a policy that relies heavily on price supports to maintain the income of its farmers. Each year the Community's member governments fix common prices of various agricultural products. These prices run above world prices. The domestic market of the Community is then protected by variable levies that tend to keep out lower-priced imports. In part as a result of this policy, the Community's share of America's total agricultural exports has tended to decline.

The decline would have been sharper if the Community's restrictions had also been applied to soybeans and soybean products--which loom large in American exports. This has been precluded by prior international agreements that permit soybeans and their derivatives to be shipped duty-free into the Community. That access has recently been threatened by the proposal of the European Commission to impose a consumer tax on vegetable oils. Quite obviously, such a tax would have much the same effect as an explicit import barrier.

The American government is also troubled by the commission's proposal to restrict imports of corn gluten--a product used in animal feeds -- which now also enters the Community duty-free on the basis of previous agreements. Since American farmers have not shared in the recent economic recovery, concern over restrictive measures against corn gluten and soybeans has become acute in the United States.

These new European proposals have thus intensified a perennial complaint of the United States--namely, that our market is far more open to agricultural imports than the Community's market. There can be no denying, however, that Europeans have some legitimate complaints about

American agricultural policies. The United States, for example, has long maintained import quotas on dairy products--a protectionist measure that has hurt European farmers. Again, American wine producers have recently been seeking Congressional limitation on wine imports.

The deplorable clamor for increasing protectionism in agriculture is not only interfering with the efficient use of labor and capital. It may also release new inflationary pressures--directly by raising food prices, indirectly by repercussions on labor markets. Nor is this all. Agricultural policies in Europe and the United States are becoming a heavy burden on governmental budgets. Programs for supporting farm prices and incomes cost the American government 28 billion dollars in fiscal year 1983 --an enormous increase over the preceding two years. The cost of supporting agriculture has also increased rapidly in the European community, reaching over 13 billion dollars in 1983. Indeed, the member governments of the Community are now engaged in an anxious search for ways of limiting the impact of agricultural expenditures on their budgets--a search that has caused severe political strains in Europe.

Foreign trade in agricultural products is thus an intra-European problem as well as a problem involving the United States and Western Europe -- for that matter, much of the rest of the world as well. A basic cause of this common problem is the tendency toward excessive production of various agricultural products. Here the Europeans have perhaps been more at fault than Americans, for the agricultural support programs of the United States have usually included some incentives to cut back production while European support programs have not. In fact, the Community's disposal of its surpluses through subsidized sales on world markets has been a source of considerable friction between the United States and the Community.

As we look ahead, the problem of oversupply may become more acute because of continuing advances in agricultural technology--especially in the grain and dairy sectors. This is clearly a problem that Community and American farmers have in common. Although our several governments recognize this, they have not yet tackled together the challenge posed by world overproduction. Fortunately, both the American government and the Community have of late moderated their rhetoric on agricultural trade issues, restrained their actions, and

tried quietly to resolve their outstanding differences. The German government, in particular, has expressed firm opposition to a European consumer tax on vegetable oils. It should be a source of some comfort to both Americans and Europeans that powerful voices of reason are being heard at a time when pressures on goverments from agricultural interests have become so insistent.

Trade in steel products is another perennial irritant in relations between the United States and the European Community. Problems in this area have recently become more troublesome, largely as a result of declining demand for steel products during the recession, but partly also because of larger production and exports by some developing countries. In view of these changed market conditions, steel firms on both sides of the Atlantic have been forced to curtail production, close some entire plants, and release many workers.

In the early 1980's, American steelmakers petitioned our government for protection against rising steel imports from the European Community. The Americans argued that European firms were benefiting unfairly from

export subsidies and that some of their products were being sold in the United States below their fair value. If their complaint had run the full course permitted by American law, the result would certainly have been a sharp reduction in European exports of carbon steel products. Fortunately, mutual good will prevailed over legal contests. After long and difficult negotiations, involving both steel producers and governments, an agreement was reached in October 1982, under which the Community undertook to limit moderately its exports of certain steel products to the United States through the end of 1985.

This agreement has worked reasonably well thus far, but it has by no means quieted the steel trade issue. The specialty steel branch of the American industry, which was not covered by the 1982 agreement, has also suffered declines in profits and employment in recent years. Its urgent appeal for relief under American law led in July 1983 to the President's approval of temporary quotas and extra tariffs for specialty steel imports. This action was severely criticized in Europe -- in part, no doubt, because it came so soon after the Williamsburg Summit. At

any rate, the European Community responded, as it had the right to do under GATT rules, by limiting certain imports of equivalent value from the United States. At times during the past year, the specialty steel problem threatened to provoke a serious rift in the relations between the United States and Western Europe. Once again, however, the matter was settled amicably thanks to the willingness of the concerned parties to make the necessary compromises. Unfortunately, both American producers and their organized workers have now joined in fresh appeals for restricting imports of steel generally. Difficulties over steel trade thus remain with us.

In view of the restlessness that continues to afflict international steel trade, there can be no escape from the conclusion that arrangements such as Americans and Europeans have recently succeeded in working out are merely temporary expedients. The critical fact is that both the United States and Europe face a common problem of overcapacity in their respective areas -- a problem that is being accentuated by rising imports from the more advanced of the developing countries. It is only by addressing together these broader issues that we can have

a reasonable chance of finding lasting solutions to our perennial problems in steel trade.

Because of limitations of time, as well as of my own knowledge, I shall not comment on other specific trade issues -- as in the case of copper, footwear, machine tools, and wines -- that are being accorded public attention in this election year. But in view of my past involvement in central banking, I do want to make a few observations about financial questions surrounding America's trade deficit that have stirred wide interest and controversy.

Let us take first the case of the dollar's appreciation. It has served to reduce inflationary pressures in the United States, but it has had the opposite effect in Europe -- since a very large part of Europe's imports is denominated in dollars. On the other hand, the dollar's appreciation has severely hurt America's foreign trade, while it has benefited the trade of other countries -- including those in Western Europe. Discerning Europeans recognize that the trade deficit of the United States has served, in effect, to drive the world economy forward. They have not, however, rejoiced

over their trade advantage, since they realize that the dollar's strength will not last indefinitely and therefore fear that the industrial structure of their countries could become distorted in the process of responding to a temporary trade advantage.

Europeans naturally prefer a stable dollar to one that oscillates in buying power, and so for that matter do Americans. But neither Europeans nor Americans have as yet found an acceptable method of returning to the kind of stability in exchange rates that existed before the abandonment of the Bretton Woods system. In a world in which capital movements often overshadow trade movements and in which inflation rates of individual countries diverge widely, central bank intervention in foreign exchange markets--a remedy that is still popular in some political circles--cannot accomplish anything beyond smoothing out the very short-run fluctuations of exchange rates.

To be sure, many Europeans feel that the appreciation of the dollar has been largely due to the relatively high interest rates in the United States. Their argument typically runs as follows: first, high American interest rates are damaging European economies by

attracting to the United States funds that otherwise would be directed to capital investment at home. Second, European interest rates are also higher than they would be in the absence of the outflow of capital to the United States. Third, the gigantic debt burden of developing countries is being compounded by the high American interest rates. Fourth, the United States could correct these difficulties by bringing down its interest rates, and this could best be accomplished by reducing the enormous deficits in the American government's budget. Finally, the American economy as well as the entire international economy would benefit in the process.

This line of reasoning has not been confined to Europeans. Many Americans have shared it -- which is not surprising since the above argument does embody a substantial element of truth. I must nevertheless point out that the above argument is incomplete. It overlooks the fact that the dollar is a haven of safety for Europeans and others in times of international political turmoil such as we have experienced in recent years. It overlooks the fact that there are causes of high interest rates beyond budget deficits. It overlooks the fact that the high American interest rates have not proved an

obstacle to a robust recovery in the United States, including a revival of both residential construction and business investment in fixed capital. More important still, the European argument overlooks the fact that profit opportunities in the United States have become distinctly more favorable than in Western Europe. Even with American interest rates remaining as they are, if European governments moved more boldly to improve prospects for business profits in their countries, the chances are that the flow of capital to the United States would be materially checked--indeed, that American capital on balance might well start moving to Europe.

The American goverment can surely be helpful to the European economy as well as to its own by proceeding resolutely to reduce its projected budget deficits. That is fully recognized by now both by the Reagan Administration and the Congress. I am entirely confident that a significant budgetary correction will be accomplished before long -- perhaps even by this summer, but certainly by next spring. As awareness of this forthcoming development spreads through financial markets, current pressures on interest rates will tend to be eased and financial investments in the United States may thus

become less attractive to foreigners. But Europe can also do its part -- namely, by improving the environment for business risk-taking, innovation, and capital investment. In short, European governments as well as the American government could take actions -- as indeed some are already doing -- to reduce the many difficulties that have been caused by high interest rates and the strong dollar. To some degree, with prospective profits in Europe beginning to improve, a wholesome process of economic revitalization may already be getting under way.

While the United States will have to emphasize one set of policies in dealing with the dollar's strength and Europe quite another, their approaches can and should be similar in dealing with the indebtedness of the developing countries -- again a problem that the United States and Western Europe have in common. Fortunately, this has been recognized on both sides of the Atlantic. Indeed, speedy action by the International Monetary Fund and the Bank for International Settlements, working in concert with the governments of the leading industrial countries as well as with their central and commercial bankers, has staved off what might otherwise have been an international financial collapse. These constructive rescue missions have not,

however, solved the underlying debt problem of the developing countries, since the debtors are being burdened with interest charges that some--perhaps many--of them may find it impossible to meet.

All concerned parties have some further contribution to make. As governments of the industrial countries continue to work at fostering sustainable growth of their economies, the developing countries will gain opportunities to increase their exports. That, along with efforts to bring down interest rates and curb protectionist impulses, is fundamental. For their part, commercial banks -- especially the large institutions that play a leadership role in international finance -- need in their self-interest, as well as for the sake of stability in the international financial system, to do more than they have yet done to ease the payments problem of debtor countries.

Typically, of course, when commercial bankers run into a debt problem of one of their business customers, they devise means of scaling down the size of the debt or the interest on it, and at times even accept the debtor company's stock in place of all or part of the outstanding debt. That business approach is suggestive of actions

that could be taken in handling the indebtedness of some of the more necessitous developing countries.

One possibility would be for a dozen or so of the major international banks to proceed on their own to cut substantially the interest rates charged to those of the less developed countries that have run into insuperable difficulties in complying with the financial program worked out in their behalf by the International Monetary Fund. Such voluntary interest-rate reductions could not in practice be generalized to cover all banks, since many of the smaller banks would balk at following the initiative of the major banks. That, however, is not a fatal objection, since the relief granted by the major international banks would of itself reduce appreciably the financial burden facing necessitous debtors.

In any event, leadership by the major international banks in interest-rate reductions is not the only possible route to relief. For example, near-term interest payments due from seriously troubled countries could be transformed into debt obligations that extend sufficiently into the future to provide the debtors essential breathing space.

Moreover, the governments of the United States and Western Europe can play a more direct role in helping the less developed countries to reestablish their credit worthiness and resume economic growth. Legislation calling for renewal of our system of trade preferences for developing countries that is now before the Congress is important in this regard. The European Community is likewise involved in renegotiating the Lome Convention which permits duty-free access of raw materials from developing countries. The existing European and American systems of general trade preference deserve extension and some further liberalization.

The developing countries must, nevertheless, be constantly reminded that it is decisively to their own benefit to expose their economies in greater degree to market forces. Continued reliance on preferential treatment is a dead-end policy, and one that will not be accepted indefinitely by the industrial nations. Developing countries must be particularly encouraged to pursue financial policies that will attract foreign investors, besides enticing back some of the enormous amounts of capital that their own frightened citizens and businesses had moved abroad. However difficult such

policies may be, there is no other way for the developing countries to achieve the full partnership that they seek in the investment and trading system of the modern world.

In bringing this address to a conclusion, I want -- even at the cost of some repetition -- to leave several basic thoughts with you. First of all, it is well to keep in mind that prior to last year, the biggest current account deficit that any country had ever experienced in a single year was about 15 billion dollars. The 70 to 80 billion dollar shortfall that my country is headed for this year is awesomely different from anything experienced in the past. Since America's trade problem involves Europe deeply, it is essential that Europeans and Americans seek better understanding of their mutual economic concerns and work together toward their resolution.

Second, as previously suggested, the United States can best contribute to easing the trade and debt problems that now confront the world by moving decisively toward greater fiscal discipline. This needs to be combined with a skilful monetary policy that tempers the robustness of economic growth and thus guards against inflationary

pressures. In Europe the foremost need is for confidence-building measures that foster job creation, so that Europe can contribute more significantly to the recovery of world trade.

Third, since the problem of international indebtedness is also without precedent -- either as to dimension or disruptive potential -- it is highly important to seek ways of enlarging upon the progress that has been achieved in the current phase of crisis management. We need, in particular, constructive initiatives that will enable the world to ride out difficulties even if economic developments in the years ahead should prove disappointing.

Fourth, the danger of protectionism has been growing despite some improvement in the condition of the international economy. In that regard, both Americans and Europeans must be concerned about the effects of protectionism on the developing world as well as about the weakening of our own economies through further protectionist actions. Even more important than that, we need to keep in mind that enmities created by trade restrictions at times spill over into the political arena,

and may even affect the capacity of the partners in the North Atlantic Alliance to cooperate as effectively as they should in meeting challenges to their common security.

Fortunately, the several dangers and needs that I have emphasized are increasingly recognized on both sides of the Atlantic. Indeed, some have already been dealt with or are at present being considered constructively. I see, therefore, ample basis for hope of a better economic future than has been our lot in the past few years.

In the course of my life, I have seen many crises come and go. I have also seen crises that were widely anticipated fail to materialize. It is always unwise to underestimate the capacity of human ingenuity and good will to resolve economic problems -- whether they be domestic or international. Let us not underrate that capacity now. As Americans and Europeans we know in our hearts that the ethical, political, and cultural values that we share in common are overwhelmingly more important than the trade or financial issues that now and then excite us.