U.S. International Transactions in 2002

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The U.S. current account deficit (the combined balances on trade in goods, services, and investment income and net unilateral transfers) increased to $503.4 billion in 2002, from $393.4 billion in 2001, or about a 28 percent increase, according to estimates of the United States Department of Commerce (USDOC), Bureau of Economic Analysis (BEA) (table 1). An increase in the deficit on goods and a decrease in the surplus on services accounted for more than two thirds of the increase. The balance on income shifted to deficit, and net outflow for unilateral current transfers increased, accounting for the remainder of the increase.[2]

The deficit on merchandise trade increased to $484.4 billion in 2002 from $427.2 billion in 2001, as goods exports decreased to $682.6 billion from $718.8 billion, and imports increased to $1,166.9 billion from $1,145.9 billion. Nonagricultural products (mainly capital goods) accounted for nearly all of the decrease in exports, while nonpetroleum products accounted for virtually all of the increase in imports. An increase in imports of consumer goods and automotive products was partly offset by a decrease in capital goods and nonpetroleum industrial supplies and materials.

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[2] U.S. Department of Commerce, Bureau of Economic Analysis, "U.S. International Transactions 2002," BEA 03-07.

Table 1
Summary of U.S. international transactions, 2001 and 2002

Item	2001	2002
	Billion dollars	
Merchandise exports	718.8	682.6
Merchandise imports	1145.9	1166.9
Balance on merchandise trade	-427.2	-484.4
Services exports	279.3	289.3
Services imports	-210.4	-240.5
Balance on services	68.9	48.8
Balance on goods and services	-358.3	-435.5
Income receipts on U.S. assets abroad	283.8	244.6
Income payments on foreign assets in the United States	-269.4	-256.5
Balance on investment income	14.4	-11.9
Balance on goods, services, and income	-343.9	-447.4
Unilateral transfers	-49.5	-56.0
Balance on current account	-393.4	-503.4
U.S. assets abroad, net outflow (-)	-371.0	-156.2
Foreign assets in the United States, net inflow (+)	752.8	630.4
Net capital inflows (+), outflows (-)	381.8	474.2

Note.—Details may not add to totals due to rounding . Figures are on a balance-of-payments basis. Exports of goods are adjusted for timing, valuation, and coverage to balance-of-payments basis, excluding exports under U.S. military agency sales. Exports of services include some goods that cannot be identified separately from services.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, "U.S. International Transactions: Fourth Quarter and Year 2002," BEA 03-07 news release, found at Internet address *http://www.bea.gov/bea/newsrel/trans402.htm*, retrieved on June 17, 2003.

The U.S. surplus on services trade decreased to $48.8 billion in 2002 from $68.9 billion in 2001 as services exports increased to $289.3 billion from $279.3 billion. Increases in exports of "other private services" category (such as business, professional, technical, and financial services), and in royalties and license fees were partly offset by decreases in travel and in passenger fares. Services imports increased to $240.5 billion from $210.4 billion as an increase in "other" private services (largely insurance) accounted for four fifths of the increase.

The balance on income shifted to a deficit of $11.9 billion in 2002 from a surplus of $14.4 billion in 2001 as income receipts on U.S. owned assets abroad decreased to $244.6 billion from $283.8 billion in 2001. "Other private receipts," which consist of interest and dividends, decreased to $110.8 billion from $151.8 billion in 2001, more than accounting for the decrease. Direct investment income receipts increased to $128.1 billion from about $126.0 billion.

Income payments on foreign-owned assets in the United States decreased to $256.5 billion from $269.4 billion. "Other private receipts"and U.S. Government payments both decreased, while direct investment payments increased.

U.S.-owned assets abroad increased $156.2 billion in 2002, compared with an increase of $371.0 billion in 2001. Foreign-owned assets in the United States increased $630.4 billion in 2002 compared with an increase of $752.8 billion in 2001.

Net inflows of foreign capital to the United States increased $474.2 billion from an increase of $381.8 billion in 2001. The broad exchange value of the dollar in real terms was about 5.0 percent lower from its February 2001 level.[3]

External Imbalances

Do external imbalances really matter? Current account imbalances grew across industrial countries as well as developing countries during the 1990s. Rising surpluses in Japan, the euro area, and some emerging-markets have been counterbalanced by deficits in other countries particularly the United States. The U.S. current account deficit is 5.1 percent of GDP and, while the deficit may be good for the world economy in the short run, a larger deficit might have a greater risk. A major concern associated with global imbalances is the possibility of an abrupt and disruptive adjustment of major exchange rates, possibly leading to an extreme decline in the value of the U.S. dollar.

Exchange rates are usually highly volatile and unpredictable, although over the medium term, real exchange rates might tend to revert back to fundamental values. However, it is difficult to predict when exchange-rate adjustments will occur, the potential risks and costs that may be associated with adjustments, and whether these costs might be mitigated by policy actions. Some have suggested that current account deficits are an outmoded concern in an increasingly integrated world, where current and capital flows are driven primarily by private rather than public decisions.[4]

However, there are a number of reasons to believe that current accounts still matter. First, adjustments–even if small–could imply significant changes in tradable goods and in real exchange rates. Second, for all the recent emphasis on globalization, levels of integration between countries remain moderate, especially for major currency areas. Third, with European, Japanese, and U.S. exports making up only 10-20 percentage points of their respective GDP, an adjustment of a few percentage points of GDP in the current account requires large changes in the tradable goods sectors, and consequently significant movements in real exchange rates. Fourth, rapid changes in exchange rates can lead to disruptive changes in the global economy.

A currency depreciation puts upward pressure on prices and wages, and often requires a tightening of monetary policy. In the 1970s and 1980s, as monetary policy played an increasing role in dealing with price inflation, the "pass-through" effect of exchange-rate changes to domestic prices fell significantly. As a result, the impact of exchange-rate changes has been

[3] The real broad value of the dollar is a weighted average of the foreign exchange value of the U.S. dollar against the currencies of a broad group of U.S. trading partners. The weight for each currency is computed as an average of U.S. bilateral import shares from and export shares to the issuing country and of a measure of the importance to U.S. exporters of the country's trade in third country markets. Federal Reserve Board of Governors, "Monetary Policy Report to the Congress," *Federal Reserve Bulletin*, March 2003, p. 108, found at Internet address *http://www.federalreserve.gov/pubs/bulletin/2003/0303lead.pdf*, retrieved on May 17, 2003.

[4] This is known in the literature as the Lawson doctrine, first put forward by Chancellor Lawson of the United Kingdom in the late 1980s.

felt more through changes in corporate profits, investment, and asset prices.[5]

Global external imbalances rose steadily among major trading countries, particularly between Europe, east Asia and the United States. Buoyant expectations of future profits due to increased productivity in deficit countries, particularly the United States, drew large capital inflows supporting the appreciation of the dollar and the depreciation of the euro. Also, large external surpluses and deficits have led to increasing divergences in net foreign asset positions across countries, with Japan building up net assets and the United States net liabilities, probably approaching or beyond their historical records.

The U.S. deficit, financed by equity flows from the euro area, comprises both foreign direct investment and portfolio equity flows. The dominance of U.S. equity markets in global capitalization has led to rising equity prices, capital inflows into the United States, and an appreciation of the dollar mirrored until recently by a depreciation of the euro. Although much concern has been raised about the growing U.S. current account deficit, research done in this area notes that because U.S. liabilities are denominated in U.S. dollars, the U.S. economy is better protected against a dollar depreciation than other countries.[6]

[5] Existing work in this area includes Mann (1999, 2002), Cooper (2001), Hervey and Merkel (2000), McKinnon (2001), Obstfield and Rogoff (2000), and Ventura (2001). See also International Monetary Fund, *World Economic Outlook – Trade and Finance*, September 2002 (IMF:Washington DC, 2002), pp. 67-80, found at Internet address *http://www.imf.org/external/pubs/ft/weo/ 2002/ 02/ pdf/ front.pdf,* retrieved on May 17, 2003.

[6] Mann, Catherine L., *Is the U.S. Trade Deficit Sustainable?,* (Institute for International Economics: Washington DC, 1999); International Monetary Fund, *World Economic Outlook*, September 2002, pp. 67-80.