U.S. Competitiveness: Beyond the Trade Deficit

GEORGE N. HATSOPoulos, PAUL R. KRUGMAN, AND LAWRENCE H. SUMMERS
Large trade deficits and the corresponding increase in U.S. international indebtedness have raised concerns about the long-run competitiveness of the United States. But being competitive requires more than balance in our foreign trade; it requires an improving standard of living. The long-term U.S. competitive problem is largely caused by low saving rates, high costs of capital, and the resulting inadequate level of both visible and invisible investment. As long as the U.S. national saving rate remains far below that of all our major competitor nations, there is little chance for restoring America's international economic position.

The extraordinary rise in the U.S. trade deficit from 1981 to 1987 and the corresponding rapid shift of the United States from the world's largest creditor to its largest debtor have focused national attention on the problem of U.S. competitiveness. Although public alarm over the trade deficit has served the useful function of bringing the problem into focus, it has also distorted the debate: the U.S. trade deficit is only a symptom of America's lagging competitiveness. The trade deficit represents, in essence, a U.S. economy that has been living beyond its means; bringing our spending into line with our income will be difficult, but the really serious problem is how slowly our income has been growing.

Does it matter if the United States is competitive? Unless the United States is able to turn its performance around, the future looks bleak. At best, the United States will experience a period of declining growth in living standards as the trade deficit is brought down, followed by a long period of slowly rising living standards associated with a steady relative decline of the United States in the world, comparable to that of Britain in the 20th century. At worst, the mismatch between our aspirations and our achievement could bring financial crisis on the Latin American model.

Warnings about U.S. competitiveness are now being widely sounded. We argue that these warnings do not put the emphasis where it belongs. Much of the explanation of the long-term U.S. competitive problem rests with low saving, a high cost of capital, and the resulting inadequate level of investment in both visible and intangible capital. As long as the U.S. national saving rate remains far below that of all our major competitor nations, there is little chance for restoring America's international economic position.

In this article, we examine the long-term problem of U.S. competitiveness. What it is, why it has emerged, and what we can do about it. First, we characterize the U.S. competitiveness problem and present evidence on its extent. Second, we analyze the roots of that problem. Third, we turn briefly to the relatively short-run issues of the U.S. trade deficit and the problems that the United States is likely to encounter in bringing it down. Finally, we offer some prescriptions for dealing with the U.S. competitive problem.

What Do We Mean by Competitiveness?

There is a strong temptation to identify the issue of competitiveness with the single measure of the trade balance. However, while trade balances sometimes indicate competitive strength, they do not always do so. For example, from 1980 through 1986 Bolivia consistently ran a trade surplus. Exports exceeded imports by more than 60% in most years, and the trade surplus as a percentage of gross national product was usually larger than that of Japan. Yet nobody would consider this a demonstration of Bolivia's competitive strength—from 1980 to 1986 the per capita output of the already desperately poor Bolivian economy fell by 26%. What was happening, of course, was that Bolivia was forced to run large trade surpluses in order to service the large debts it had incurred in earlier years. Meanwhile, the real productive capacity of the economy was declining, in part because of the burden posed by the need to run large short-run trade surpluses. (This experience, although extreme, is not without relevance to the prospect that the United States now faces.)

The proper test of competitiveness, then, is not simply the ability of a country to balance its trade, but its ability to do so while achieving an acceptable rate of improvement in its standard of living. Neither rising living standards nor balanced trade are themselves enough to make a country competitive, since rising living standards can be achieved through growing trade deficits (as in the United States since 1981), whereas trade can be balanced through a steady decline in a country's relative standard of living (as in Britain since World War II and, perhaps, the United States in the 1990s).

What is an acceptable rate of improvement in living standards? An advanced country like the United States, which possesses many natural advantages, should be able to maintain a living standard at least as high as that of other advanced countries; thus, we would not view the United States as competitive unless it is able in the long run to maintain a rate of growth in living standards that keeps pace with that of the rest of the industrial world.

The U.S. Standard of Living

The United States retains the highest standard of living of major nations. However, our success in raising that standard of living in the past 15 years has been disappointing in comparison with our own past achievements, the experience of other countries, and our own potential.