U.S. Trade Deficit Rises Sharply

By Patrice Hill
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The U.S. trade and investment deficit with the rest of the world ballooned to $805 billion last year, for the first time reflecting a spiral of rapidly growing debt service costs caused by rising interest rates.

The surge in the external deficit, which is larger than any other nation's at 6.4 percent of economic output, comes as the United States is spurning foreign takeovers of ports and oil companies and raising doubts about its ability to keep financing such unprecedented levels of debt, analysts say.

"It is certainly something to worry about," said Martin Feldstein, an economics professor at Harvard University and president of the National Bureau of Economic Research.

"Continuing to attract funds when the current-account deficit is that large and continuing to rise is bound to become a serious problem."

The deficit, which consists primarily of a $782 billion imbalance of trade in goods such as cars, televisions and oil, has almost quadrupled from $214 billion in 1998 and more than doubled from $390 billion in 2001, President Bush's first year in office.

The deficit amounts to about $2.2 billion a day in funds from abroad -- about the equivalent of one DP World ports deal every three days.

These funds, culled from every nation from Asia to the Middle East and Canada, mostly are invested in U.S. stocks and bonds, including the mortgage-backed securities that finance purchases of American homes.

The deficit hit a milestone in the middle of last year when for the first time the amount of money foreigners earn from interest and dividends on their U.S. investments surpassed the amount U.S. citizens earn from their investments abroad.

That "income" gap, though small at $2.4 billion in the fourth quarter, is expected to rise exponentially as U.S. debt and interest rates continue to climb.

A study released by the National Bureau of Economic Research this month concluded that the U.S. faces "a day of reckoning" soon from the pileup of debt, which will be marked by a drop in both economic growth and the value of the dollar and financial markets.

Economist Sebastian Edwards, author of the study, said that because of the sheer enormousness of U.S. debts, a sharp economic decline is the most likely scenario, with gross domestic product falling by as much as 5 percent in what would be a deep recession.

"Painful and costly" is how he put it. "Major current-account reversals have tended to result in large declines in GDP."

Even under a "best case scenario" in which foreign investors keep increasing their appetite for U.S. assets and double their holdings to the equivalent of 60 percent of economic output, the disruptions will be "considerable," he said.

"The U.S. is moving into uncharted waters," he said. "Never in the history of modern economics has a large industrial country run persistent current-account deficits of the magnitude posted by the U.S. since 2000."

The sustainability of the mounting deficits "depends on whether foreign investors will continue to add U.S. assets to their investment portfolio," he said.

The U.S. has had little problem attracting capital from abroad in recent years despite the rapid buildup of debt. But that may be changing as protectionist sentiment grows in Congress and stifles efforts by foreign investors to acquire U.S. assets.

In recent months, a sharp public outcry and political backlash blocked attempted purchases of some U.S. port terminal operations by an Arab-owned company and a U.S. oil company by a Chinese-backed firm.

The difficulties those foreign buyers encountered have raised questions among investors in Asia, which is the region the U.S. has relied upon the heaviest to finance its external deficits, said Rossman Ithnain, economic counselor at the Singapore Embassy.

Foreign investors worry that they could encounter discrimination against non-Americans and lose their investments, he said.

The rejection of the DP World acquisition also spawned a backlash by the host country, the United Arab Emirates, which announced that it is reducing its dollar reserves by 10 percent.

Any widespread move by Asian, Arab or oil-producing countries to divest themselves of dollars could trigger a run on U.S. markets and precipitate a current-account crisis, analysts say.

Federal Reserve Chairman Ben Bernanke expressed hope yesterday that the U.S. economy will remain strong and withstand the economic adjustment when the deficit finally reverses.

Although U.S. incomes currently are sufficient to repay the debt owed to foreigners, he said in a letter to Congress, "as our net external debt rises, the cost of servicing that debt increasingly will subtract from U.S. income."

The best way to reduce the external deficit would be to increase national savings by reducing the federal budget deficit of about $400 billion, he said. He added that "maintaining an environment conducive to investment and growth" also is important.