Trade deficit on course for surplus

Cheaper fuel helps cut costs for goods made in America

By Patrice Hill - The Washington Times Tuesday, December 25, 2012

While Washington wrestles with the nation's burgeoning budget deficits, some good news has emerged on the other deficit front: The nation's bloated trade deficit appears to be turning the corner, with at least one prominent economist predicting it will disappear altogether within a decade.

A recent wave of "re-shoring" of overseas manufacturing plants by U.S. chemical, auto and other companies signals the revival of U.S. competitiveness in many industries vis-a-vis Europe, Japan, China and other major trade partners. The trend got a big push recently from a dramatic drop in American natural gas prices, making the U.S. a highly desirable location for manufacturers relying on gas for energy and as a component in plastics, chemicals and other essential materials.

Rising U.S. competitiveness has stoked a major export revival since 2009, helping pull the economy out of recession. Many analysts have been surprised by how well exports have held up this year despite the slide back into recession of the largest U.S. export market — the 17-nation eurozone — and a major slowdown in the nation's fastest growing market — China.

The export revival owes to a constellation of U.S. trends that have been building for years, including a pronounced weakening of the dollar against other major currencies, high productivity growth and subdued wage increases, and rising fuel and transport costs that make it more expensive for manufacturers overseas to deliver goods to customers in the U.S. American farmers also are helping the balance of trade by becoming beneficiaries for rising living standards in China and other emerging countries, driving farm prices to near-record levels.

On the import side, there has been a trend toward saving more and spending less among U.S. consumers and a dramatic reversal of U.S. energy consumption and production trends since 2005 that has put a lid on American oil imports and promises to turn the U.S. into a net energy exporter in coming decades. America's gigantic oil deficit has been second only to the gargantuan trade deficit with China as a major driver of chronic U.S. trade gaps that surged to more than $800 billion at their peak in 2006.

"The secular trend of the U.S. trade deficit is a great, positive story," said David A. Levy, chairman of the New York-based Jerome Levy Forecasting Center. "The trade gap has been an enormous [drag on the economy] for over three decades. America may be only a decade from running consistent merchandise trade surpluses."

Oil deficit on the wane

Trade deficits act like a dead weight on the economy by draining the wealth of the country and bleeding domestic industries. U.S. leaders have been worried about bloating deficits since the 1970s with a surge in oil imports from the Middle East.

The sea change in oil exports this year has been breathtakingly fast — narrowing the trade deficit in September to the lowest in two years as U.S. production of oil from shale formations in Texas and North Dakota led to a surge in petroleum exports.

"The revival in domestic oil production is narrowing the U.S. deficit" even amid a lull in manufactured exports brought on by the European recession, said Nigel Gault, an economist with IHS Global Insight. The current account deficit, the broadest measure of merchandise and service flows, fell 9 percent to a 31/2-year low of $107.5 billion in the third quarter, the Commerce Department has reported, and IHS expects it to stay in that low range or even make further progress next year despite the global slowdown.

Coming home

While the federal government could play more of a role in boosting exports through tax reform and training assistance, business groups say, some industries are already staging a comeback without help from Washington, thanks to improving trends in the marketplace.

Petrochemical companies such as The Dow Chemical Co., Royal Dutch Shell PLC, Chevron Phillips Chemical Co. and Exxon Mobil Corp., which moved plants overseas a decade ago, are relocating to the U.S. and considering building plants here to take advantage of the lowest natural gas prices on the planet. Because chemicals and plastics are core ingredients for many other manufactured goods, this trend promises to coax even more manufacturers to locate in the U.S.

"The boom in gas and unconventional oil extraction may generate a significant number of new jobs," said Dieter Ernst, an economist with the East-West Center. "It reduces one of the main cost factors for petrochemical products such as plastic, which could accelerate investment in a broad range of domestic industries."

A report from the National Intelligence Council this month said that the lower gas and oil prices in the U.S. brought on by the shale boom would have "significant positive ripple effects" for the U.S. economy, possibly increasing jobs in extraction and manufacturing industries by as much as 3 million by 2030, while helping to "significantly reduce" the trade deficit.

"The most important domestic energy development in the last 50 years is poised to reshape American manufacturing," said Kevin Swift, chief economist of the American Chemistry Council, who noted that increasing production in the U.S. this year turned a chronic trade deficit in chemicals into a modest surplus.

Has China peaked?

Analysts see progress as well on the other major cause of the trade deficit: China. After decades of jobs and industries lost to China, some analysts say, the pendulum is starting to swing back toward the United States.

"There is growing evidence that China's challenge to U.S. manufacturing has peaked, and its competitive advantage is in decline," said Jerry Jasinowski, former president of the National Association of Manufacturers. "The resurgence may be even stronger and more broader-based than most people realize."

A study last year by the Boston Consulting Group found that the cost of producing goods in China is rising rapidly. China has the fastest growing wages of any country and has had to pay steeply higher bills for the oil, coal, copper and other raw materials it imports in massive quantities from abroad to feed its manufacturing base. The costs of industrial real estate, energy and transportation have been escalating in China as well, and citizens are demanding more safety and environmental controls, making it more expensive for manufacturers to locate there.

China's sharply rising costs for basic materials and housing drove up inflation 7 percent there last year, forcing the government to douse the inflation fires with tighter lending policies that produced a sharp slowdown in China this year. Within five years, the Boston Consulting Group predicts, the cost of producing goods in China's coastal cities will be only 10 percent to 15 percent less than in some regions of the U.S. — not enough of an advantage to overcome the high legal, transportation and inventory costs of manufacturing there.

For this reason, the group cites a growing list of companies moving production back to the U.S. from China, including NCR Corp., the Coleman Co., Ford Motor Co. and the Outdoor GreatRoom Co.

"The tide is turning in our favor," said Mr. Jasinowski, citing the "strongest productivity growth in the industrial world" and subdued wage growth that has made the U.S. more attractive to global companies such as General Electric Co. and Apple Inc., both of which have announced plans to locate facilities at home after years of moving abroad.

Plenty of skeptics, however, question whether the U.S. is losing its appetite for cheap Chinese imports.

"The data say almost exactly the opposite," said Alan Tonelson, a research fellow at the U.S. Business and Industry Council, which represents small U.S. manufacturers that compete with the Chinese.

"If China's manufacturing clock is rapidly being cleaned by America, why have the Chinese taken the global industrial output lead during the past two years?" he asked, citing an IHS Global study. "Why did the U.S. manufacturing trade deficit with China set a new monthly record in October?"

End of trade deficits?

But the view that the trade deficit is on the wane has gained some prominent backers. Mr. Levy, the New York forecaster, said he is convinced that the U.S. has turned the corner on trade, thanks to a combination of declining oil imports, soaring farm exports and a sea change in global manufacturing. He predicts that the chronic trade deficits that have been in place since the 1970s will all but disappear as the economy gains momentum.

But even the optimistic Mr. Levy has been surprised at how quickly declining fuel use and increasing oil production in the U.S. have deflated the oil gap this year.

"It's striking," he said, but the renaissance in manufacturing has been building for a decade. Mr. Levy traces the comparative advantage of the U.S. to the automation of many manufacturing processes previously performed by unskilled workers. That means companies now need fewer but more highly skilled workers who are more likely to be found in developed countries such as the U.S.

"As the direct financial advantages of cheap labor declines in many industries, other factors become more important — supply chain protection, technology security, transportation costs" — all areas in which the U.S. shines in comparison with its competitors, Mr. Levy said.