# DO MULTILATERAL TRADE AGREEMENTS HELP OR HINDER THE U.S. CURRENT ACCOUNT BALANCE?

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**ABSTRACT**

*This paper investigates the effects of Regional Trade Agreements (RTAs) also known as bilateral or multilateral trade agreements on the U.S. current account balance. In contrast to the common belief that RTAs provide export opportunities for U.S. companies, hence improve the U.S. trade balances that are part of the U.S. current account balance, this paper shows that trade agreements adversely impact both of these accounts.*

**JEL:** F, F13

**KEYWORDS:** Trading Bloc, Regional Trade Agreement, Current Account Balance

## INTRODUCTION

The current account is composed of four sub-accounts: (1) Merchandise trade consists of all raw materials and manufactured goods exported, minus those that are imported, (2) Services include tourism, transportation, entertainments, engineering and business services, such as law, management consulting and accounting, as well as fees from overseas amusement parks, such as Euro Disney' patents and copyrights on new technology, software, books, music and movies also are recorded in the service category, (3) Income receipts include income derived from ownership of U.S. assets abroad, such as dividends on holdings of stock and interest on securities, and (4) Unilateral transfers represent one-way transfers of assets when Americans donate humanitarian aids to other countries. (Using the above methods, bilateral and multilateral trade agreements first affect Balance on Merchandise Trade, then the current account. Their final impact can be observed in the Capital and Financial accounts which are on the other side of the ledger in the balance of payment accounting.) Although politicians portray these agreements a positive influence on the U.S. trade, the reality is somewhat different.

The U.S. trade deficit with its Canadian and Mexican partners in NAFTA (North American Free Trade Agreement) is running about $100 billion a year. Similar deficits exit with the U.S.'s partners in the Central America Free Trade Agreement (CAFTA). U.S. has persistent surpluses with countries in which no trade agreements currently exist, such as Brazil, Hong Kong, Australia and the Netherlands. Therefore, U.S. trading partners are reaping the benefits of the trade agreements and the U.S. comes out short. A review of the literature shows that many studies distort the effects of multilateral trade agreements by exaggerating incremental U.S. exports and underestimating imports from the partnering countries. This research paper attempts to dissolve the myth of the positive influence of the multilateral trade agreements on U.S. exports and job creation. This article first presents a review of literature, followed by a data analysis which projects the U.S. current account balance. The results and concluding remarks are presented at the end of the article, which shows that this projected "balance" is severely undermined by presumably "good" trade agreements.

## REVIEW OF LITERATURE

Simonelli (2007) demonstrated that multilateral trade agreements commenced after a long period of negotiation which on average takes about 10 years. Spending this length of time for an agreement which has questionable benefits for the United States also undermines the work of World Trade Organization (WTO) whose main responsibility is to reduce trade and non-trade barriers at the global level. Moreover, even if a trade agreement is proven to benefit the U.S. trade balance it should not be approved without a vigorous study of the impact of the additional trade on the environment.

Robalino and Herrera (2010), using the example of Mexico, revealed that deforestation is one of the side effects of additional trade that plays a significant role in the overall balance of carbon in the atmosphere exacerbating the effects of global warming. With the regional trade growing at the rate of 12 percent per year, this trend must be expected to continue Foster & Rosenzweigh (2009). Regional trade agreements (RTAs) are proliferating. According to Freun and Ornelas (2010), the average WTO member now has agreements with more than 15 countries. The expected gains from such increased openness to trade stem from the assumption that resources will flow to their most productive uses and lower consumer prices. These authors also warn about preferential liberalization, which can result in creating trade within the members of RTA at the expenses of non-members. While trade creation is associated with the standard gains from trade, trade diversion can make a trade agreement harmful for both members and nonmembers. The consequences of regionalism are generally tied to whether the trading bloc is open to others or not. Yi (1996) shows that regionalism (with custom unions - CUs) is a building bloc to free trade, if it is open. However, if is not open it can be a stumbling block. A set of related studies reveals the long-run equilibrium of bilateral agreements that are supported by both countries. This literature finds that the spread of regionalism mostly leads to free trade provided that the countries trade policies are symmetrical (e.g., Goyal & Joshi 2006). However, in accordance with Riezman's (1999) finding, regionalism can be either a stumbling bloc or a building bloc when the benefits are unevenly shared by the countries involved (Saggi & Yildiz 2010).

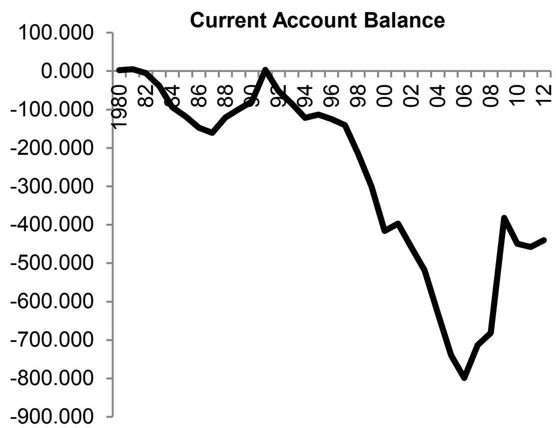
Researchers have identified a number of macroeconomic variables influences U.S. export growth. For example; Jun Nie and Lisa Taylor found that U.S. export growth depends on the economic growth in the rest of the world. Not many scholarly papers have examined the effects of growth in the service sector and petroleum production on the U.S. current account balance. As shown in Figure 1, except for 1990, Americans have run an annual current account deficit with the rest of world in every year since 1982. That unbroken string of deficits has colored much of the trade debate in the United States in the last two decades. Indeed, the deficit was partly to blame for a wave of angst in the late 1980s over American "decline." Best-selling books such as Paul Kennedy's *The Rise and Fall of the Great Powers* and Clyde Prestowitz's *Trading Places: How We Allowed Japan to Take the Lead* caught the mood of the time.

## DATA AND METHODOLOGY

*Projection of the Current Account Balance :* Throughout the 1980s and 1990s, the current account deficit spawned worry about "unfair" foreign trade barriers, lost jobs, and America's ability to compete in the global marketplace. However, the argument of this section will show that none of these statements are true. Beginning in the early 1990s, annual U.S. trade deficits reached unprecedented levels. After decades of postwar surpluses, the U.S. current account deficit reached a record of $800 billion in 2006, as a percentage of GDP, it approached the unprecedented level of 6% (see Figure 2). In the aftermath of the global financial crisis, the current account deficit started to shrink. By 2009, the account trade deficit was cut in half to less than $400 billion, which shattered all doom and gloom projections in this area.

In 1998, two years after the 1996 Asian financial turmoil, Daniel Griswold (1998) from the Cato Institute wrote an article about the U.S. trade deficit. One of the main points of his article was the following: the U.S. trade deficit is not caused by unfair trade practices. He also mentioned a survey of America's major trading partners that revealed there is no relationship between bilateral trade balances and openness to U.S. exports. These points are valid but less important since in recent years we are observing inflection points in all trade data that make much of the previous trade analysis erroneous. In 2014, five years after the global financial crisis, I broaden Griswold’s research from a mere trade balance to the U.S. current account balance and examine the most recent data and analyze the current account in relationship to the recent trade agreements.

Figure 1: The U.S. Current Account Balance ($Millions) Figure 2: The U.S. Current Account Balance As Percentage of GDP



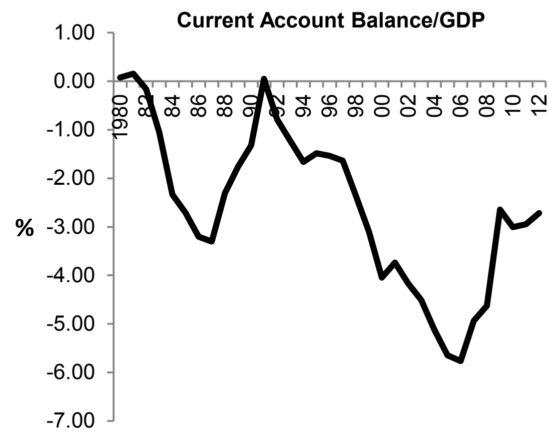




*Figure 1 shows quarterly data of the U.S. current account balance from 1980 through 2013. The inflection point took place in the last quarter of 2006 and the improvement is continuing. Source of Data: U.S. Bureau of Census and Federal Reserve Economic Data. Retrieved from http://research.stlouisfed.org/fred2 Figure 2 shown the U.S. current account balance as a percentage of U.S.GDP. Again inflection point happens in 2006 and the improvement is continuing. Source of Data: U.S. Bureau of Census and Federal Reserve Bank of St. Louis. Retrieved from http://research.stlouisfed.org/fred2*

Hojjat (2014) demonstrated that the U.S. Current Account balance will reach equilibrium by 2020. Figure 3 shows this projection which uses Bureau of Census quarterly data on the four sub-accounts of the U.S. current account balance and the following three assumptions: (1) Four percent improvement of trade in services per year, (2) Increase in export of LNG from 1 billion CF in 2014 to 6 billion CF by 2020, and (3) A reduction of 4 percent in imports of petroleum products. This projection was confirmed by both cross sectional and time series forecasting.

Figure 3: Projected U.S. Current Account Balance ($B)

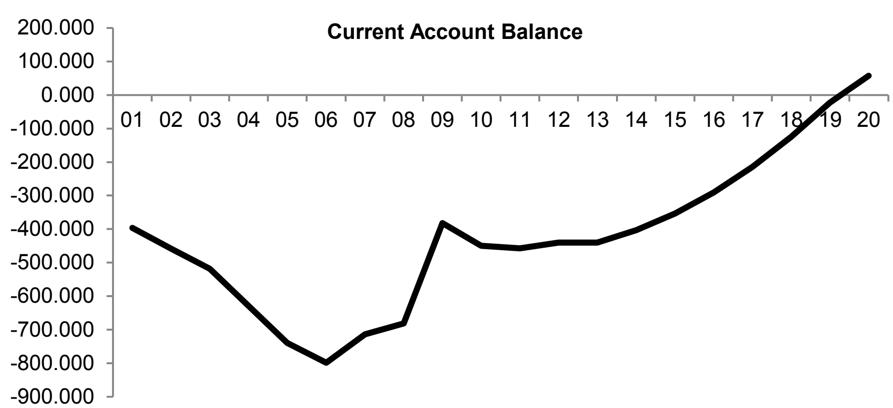



*Figure 3 is the projection of the U.S. current account balance based on cross sectional analysis of trade and service accounts of the U.S. balance of payments account. The assumptions include 4 percent increase in the service account, four percent decline on petroleum imports and a gradual increase in LNG exports from Louisiana and Maryland LNG ports. For more information see Hojjat (2014): "Cross Sectional and Time Series Forecast of the U.S. Current Account Balance"*

Table 1 is the numerical presentation of the above graph, showing a positive balance by 2020. Both time series and cross section projections display a rather robust outlook for the U.S. current account balances. Both are projecting that by 2020 the U.S. will have a current account surplus.

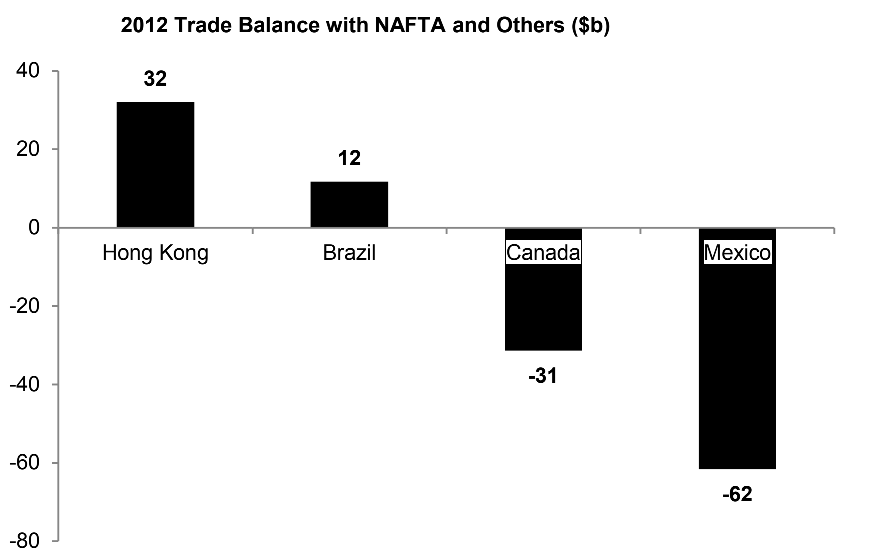
Table 1: Projected U.S. Current Account Balance Using Time Series Data ($B)

| | |
|---|---|
| 2014 | -193.22 |
| 2015 | -149.36 |
| 2016 | -105.5 |
| 2017 | -61.64 |
| 2018 | -17.78 |
| 2019 | 26.08 |
| 2020 | 69.94 |

*Table 1 presents the projection of the U.S. current account balance, equilibrium will be achieved by 2018 and for the first time in 4 decades U.S. will have a surplus in the current account balance by 2020*

Since the focus of this research is to show if the RTAs help or hinder this projection, readers can review the projection in the above referenced citation. Multilateral Trade Agreements and the U.S. Current Account Balance : The most important economic truth to grasp about the U.S. current account deficit is that it is affected by trade policies. Commencing new trade agreement may initially improve the U.S. trade deficit but it has always resulted in a huge trade imbalance in a longer term. The following figure proves this point.

Figure 4: 2012 U.S. Trade Deficits with Selected Countries




*Data in Figure 4 retrieved from www.export.gov. It shows that U.S. has been running trade deficit with countries that has Regional Trade Agreements and surpluses with selected countries that does not have trade agreement*

As shown above, the trade deficit with our trading partners in NAFTA has been creating close to a $100 billion dollar deficit year after year going back more than a decade. The same thing is true about the Central America Free Trade Agreement (CAFTA). At the same time, the U.S. has persistent surpluses with countries with which no trade agreements currently exist, such as Brazil, Hong Kong, Australia and the Netherlands. Therefore, multilateral trade agreements increases U.S. trade, but this is like expanding a two-lane highway of trade into a six-lane highway; four lanes coming in for imports and two lanes going out for export. It has more benefits for the U.S. trading partners than for U.S. exporters.

On the other hand, working within the framework of the WTO to reduce tariffs and NTBs will benefit all member counties, as well as U.S. consumers who will have more choices and lower prices due to the higher level of competition. In this regard, to describe other countries as currency manipulators is a wrong trade policy. This is both an allegation which brings politics into trade policy, and it has never been proven. As shown in the above graph, the protectionist policies of other countries have not significantly affected U.S. trade balances. The U.S. has trade surpluses with rather protectionist countries, such as Brazil, and deficits with Canada and Mexico, which are considered free traders and are members of NAFTA. The same cannot be said for our bilateral deficit with China. Despite substantial progress in the last 10 years, its barriers to imports remain relatively high. Those barriers partly explain the bilateral surplus China runs with the United States, but the primary explanation is more benign: We like to consume the products China sells. In 1995 the Council of Economic Advisers concluded, "China's persistent surplus with the United States in part reflects its specialization in inexpensive mass-market consumer goods. China similarly runs bilateral surpluses with Japan and Europe for this reason."_ Griswold (1998) asserted that: *"If China were to further open its market, America's bilateral deficit with China would probably shrink, but our overall trade deficit—determined by aggregate savings and investment—would remain largely unaffected."* How true is this? As shown in the following graph, Dr. Griswold was overly optimistic with regard to our trade deficit with China.

Figure 5: U.S. Trade Deficit with Major Trading Partners

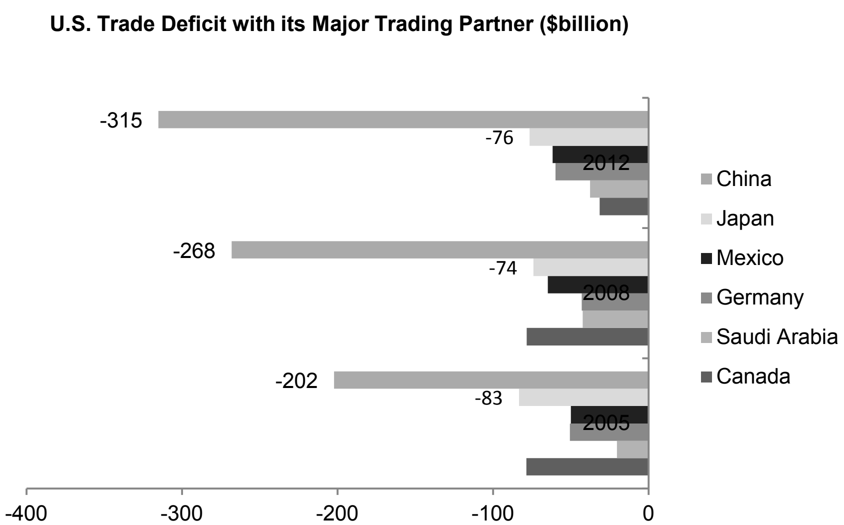



*Figure 5 presents U.S. Trade imbalances with its six major trading partners. These deficits, from 2005-2012 have become a permanent part of U.S. trade pattern. Trade agreements can further exasperate these imbalances and retard the current improvement in the U.S. current account balance. Source of Data: Bureau of Economic Analysis, U.S. Department of Commerce*

The deficit with China has been ballooning. It is now over 43 percent of the total U.S. trade deficit. See the following graph. The U.S. should complain about the Chinese protectionist policy to the WTO, where it would find many sympathetic ears among countries that have similar deficits with China, and China as a member of WTO has to comply with its ruling.

Figure 6: U.S. Trade Deficit with China

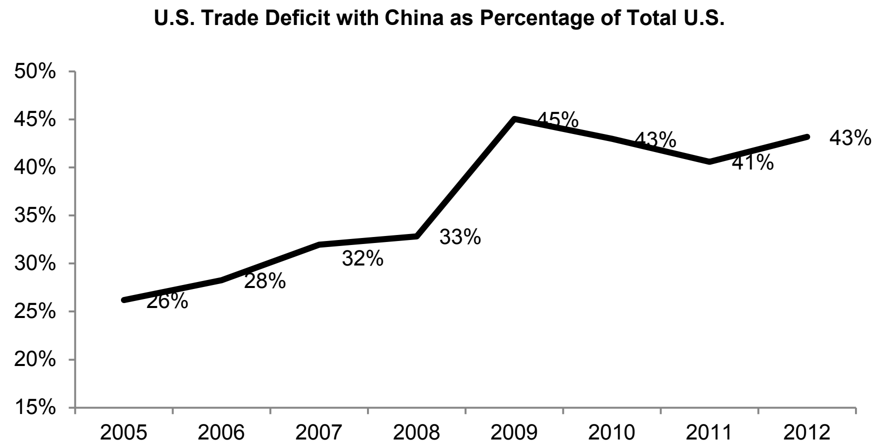



*Figure 6 reveals the danger of continuing trade deficit with China. It shows that over 40% of the U.S. trade deficit with the world income is due to imbalance trade with China. If this deficit remains unchecked, it will derail the trend toward U.S. current account surplus by 2010.*
*Source of Data: Bureau of Economic Analysis*

## RESULTS

Given the fact that multilateral trade agreements do nothing but deteriorate the U.S. trade position, why do U.S policy-makers legislate them? The answer is beyond the scope of this article but anyone with knowledge of the hegemonistic intentions of U.S. foreign policy, supported by huge corporate lobbying groups, would not be surprised if the U.S pushes even further to bring additional groups of countries under its umbrella - Moyer (2013). The formation of regional trade agreements is more about the politics than economics and job creation. In short, multilateral trade agreement increases U.S. trade but it is like expanding a two-lane highway of trade into a six-lane highway; four lanes coming in for imports and two lanes going out for export. It had more benefits to the U.S. trading partners than to the U.S. exporters.

## CONCLUDING COMMENTS

The goal of this paper is to show that there is a brighter future waiting the U.S. current account balance and to warn that this brighter future can be harmed by a reckless push toward more regional trade agreements, including a possible custom union with Europe. The U.S. current account deficit is shrinking due to the underlying strength in the U.S. energy sector. Higher gas efficiencies in cars have reduced the consumption of oil in the U.S. More domestic oil production and the upcoming start of LNG exporting will dramatically brighten the U.S. current account balance. According to our forecast, by 2020 the U.S. will have a current account surplus with the rest of the world. However, there are some stumbling blocks in the way of this forecast. The most important one is the proliferation of trading blocs in which the U.S. is engaged. This paper clearly shows that bilateral and multilateral trade agreements do not help the U.S. current account balance, in fact they do the opposite, i.e., they add the U.S. current account deficit. These agreements are designed to gain political advantages and to keep corporate lobbyists happy. There is a limitation to this research is related to the forecast of the U.S. current account. This discussion was curtailed to limit the length of the article. For details, researchers are encouraged to read Hojjat (2014). A research of this topic can be advanced by examining the effects of potential trade agreements with China and Europe on the U.S. current account balance.

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