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NEWS: ANALYSIS & COMMENTARY

The Export Engine Needs A Turbocharge

A decade ago, many economists were optimistic that U.S. companies would be able to boost exports strongly enough to keep up with Americans' rapidly rising appetite for imports. Most predicted that the U.S. trade deficit would stabilize at perhaps a fraction of 1% of gross domestic product. But while imports have boomed, exports have grown far more slowly than anyone expected, contributing to the biggest trade gap in history. The Commerce Dept. said on Jan. 28 that the trade deficit in goods and services hit an annual rate of $688 billion in the fourth quarter of 2004, a record 5.7% of GDP.

Understanding why exports have fallen short is vital to explaining the size of the trade deficit -- and the prospects for shrinking it. "This is one of those controversial [economic] issues," says Farid Abolfathi, a managing director at Global Insight Inc., a Lexington (Mass.) economic consulting firm. The problem isn't just the decline of U.S. manufacturing over the past decade. Indeed, the worst-performing export sector in recent years has not been goods. The less understood segment of "services" -- which range from airline trips to international phone calls to movie royalties, U.S. tourism, education of foreign students, and legal advice -- has lagged more.

The bottom line? While economists continue to puzzle out why exports haven't grown faster, few expect a rapid turnaround. It could be five years or more before export growth makes a big dent in the trade deficit. That's because the U.S. is at the bottom of a deep hole. True, exports grew 17% over the past four quarters, vs. just 8% growth for imports. But because the $1.9 trillion total that the U.S. imports is so much larger than the $1.2 trillion it sells abroad, exports need to grow 58% faster than imports just to keep the trade gap from increasing.

Faster growth in exports of services will be vital. From 1996 to 2004, service exports rose just 27% after inflation, vs. 34% growth in goods exports. Travel and passenger fares purchased by foreigners fell in real terms, reflecting sluggish performance by U.S. tourism and airlines in the face of wars, visa restrictions, and for much of the period, a strong dollar. Royalties and license fees from other countries grew 38% -- a number that was suppressed by intellectual-property theft. Hollywood alone estimates that it loses about $3 billion a year from movie piracy.

The fastest-growing service export category has been "other private services," a grab bag that includes education, legal, accounting, finance, insurance, and telecom. It has grown 79% after inflation since 1996. But even there, growth is less than it could be. Many U.S. companies, from PricewaterhouseCoopers to insurer American International Group Inc., are choosing to serve foreign markets from local offices rather than from the U.S.

It's also likely some service exports are being missed. When a U.S. company opens a plant abroad, as many have, it provides management as well as intellectual property, such as patents and trademarks, from the home office. Those should be recorded as exports of services, but they may not always be, says Ralph H. Kozlow, associate director for international economics in the Commerce Dept.'s Bureau of Economic Analysis. He says the bureau is looking into undercounting of service exports and imports.

Don't look for miracles from goods exporters, either. Sure, some sectors are doing fine. The boom in mining around the world has boosted Caterpillar Inc.'s (**CAT**) exports of its gargantuan trucks and earth movers. But others are slipping. Agriculture, long one of the strongest export sectors, has recently flirted with trade deficits because of rising foreign competition, such as from Brazilian soybean farmers. Even the chemical industry, where exports have risen briskly since the mid-1990s, is flagging. 3M Co. (**MMM**), which exported $3 billion more than it imported last year, says it's making more investments abroad than at home.

Policymakers' two favorite ways to raise exports and shrink the deficit are faster foreign growth and a cheaper dollar, but neither is a quick fix. Even if both Japan and the European Union boosted their annual growth rate by 2 percentage points and their imports from the U.S. went up the same amount, overall U.S. exports would rise a trivial $6 billion a year. And the dollar is still off by only 15% from its peak three years ago, according to the Federal Reserve's trade-weighted, inflation-adjusted index. That won't markedly boost sales of U.S. goods and services.

Increasing exports is key to shrinking the trade deficit. The question now is, what's the key to increasing exports?

By Peter Coy in New York, with Adrienne Carter and Michael Arndt in Chicago, and bureau reports

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