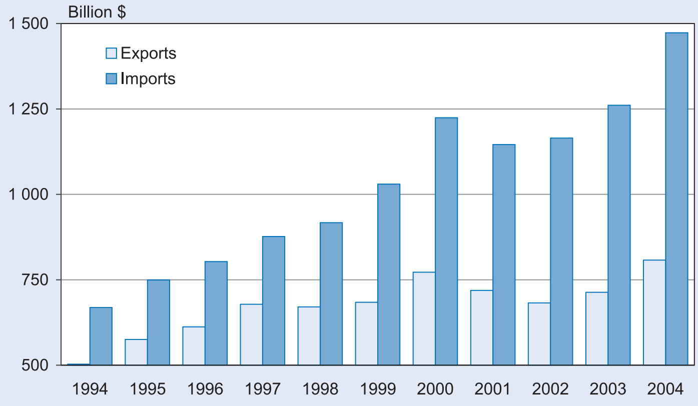
ELASTICITY ASYMMETRY IN THE UNITED STATES

US EXPORTS AND IMPORTS OF GOODS



Source: Bureau of Economic Analysis.

The huge US trade deficit has many reasons. The one most often cited is that US consumers are spendthrifts in general and that a lot of their spending goes for imports. But that is not the whole explanation, as there are two sides to a trade balance. For a trade deficit to be sustained, US consumers must spend more of their income on buying imports than foreigners are spending on US exports. In fact, even if the US economy were growing at the same rate as the rest of the world, the US trade deficit would widen as US consumers suck in relatively more imports. This is known as the Houthacker-Magee Asymmetry[1]: US income elasticity for imports is greater than the foreign income elasticity for US exports.

A recent article by the OECD (2004) spells out four explanations for the asymmetry:

- Demographics: Younger populations tend to consume a relatively higher proportion of imports, and fewer domestic services like health care, while immigrants tend to maintain their tastes for products from home.
- Supply factors: There is a tendency for countries with higher growth rates to produce a larger variety and quality of goods for export, which in turn increases the foreign demand for those countries' products. This supply effect is sufficiently important that it may account for around half the estimated income elasticities of US import demand.
- Production relocation and vertical integration as well as improvements in global and regional market access.
- The composition of US trade: There is evidence that the elasticity asymmetry is present only for trade in goods and reverses for trade in services. The implication is that the U.S. has a greater comparative advantage in services than in goods.

Can anything be done? Two main channels for narrowing or reversing the elasticity asymmetry suggest themselves. The first would involve an expansion of services exports. This could happen by further liberalisation of trade in services, for as investment in new economy services deepens globally, the export performance of services within US trade would rise. The second would involve continued strong productivity growth in the United States, accompanied by a pickup in the variety and quality of goods and services for export.

There are a number of risks, however. First, a further liberalisation of trade in new economy services may be hampered by protectionist pressures. Second, deeper integration of new economy services may enable US trading partners to produce a greater variety and quality of goods for export. This could directly offset the assumed supply-side improvement in US export performance.

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References

Houthakker, H.S. and S. Magee, 1969 "Income and Price Elasticities in World Trade," *Review of Economics and Statistics,* 51, III–125.

OECD (2004), "Channels for narrowing the US current account deficit and implications for other economies," Economics Department, working paper 390.

[1] After Houthakker and Magee (1969) – the first to document the trend.