The Eurozone and U.S. Export Competitiveness in Manufactures

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Intense discussion of the eurozone financial crisis has centered on fiscal accounts and the banking sector. Little attention has been paid to the impact on trade beyond the obvious fact that if there is slower eurozone growth, import growth will also be down. The adverse trade impact of the eurozone on third countries, however, and on U.S. exports of manufactures in particular, is significant and growing, and faces uncertain prospects ahead.

The adverse impact on U.S. manufactured exports is principally a result of the currency undervaluation of the eurozone northern tier export powerhouses, most importantly Germany and the Netherlands, as reflected in the great diversity in current account balances among eurozone members. Surpluses, as a percent of GDP, of 5 percent for Germany and 7 percent for the Netherlands, stand in striking contrast to deficits of 8 percent for Greece and 4 percent for Italy and Spain. France has a southern tilt with a deficit of 2.5 percent.

This disparity in current account balances is, in fact, the root cause of the eurozone financial crisis, but the discussion here is limited to the adverse impact on U.S. export competitiveness, which stems from two reasons. The first is that, from the outset, higher productivity growth in northern tier export industries, estimated to be an accumulated 30 percent, has resulted in a progressively larger undervaluation of the single currency, which increases their export competitiveness. The second reason is that since 2010, the eurozone financial crisis has caused a shift from euro- to dollar-denominated financial assets, with a resulting 12 percent decline in the euro exchange rate to the dollar, increasing relative export competitiveness for all eurozone members.

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How much impact this exchange rate effect has had on U.S. exports relative to EU exports, in global markets as well as within the eurozone, cannot be quantified, although trade in manufactures is highly price-sensitive and therefore exchange rate–sensitive. The broad figures for U.S. and EU exports of manufactures over the past decade, moreover, have been strongly adverse for the United States, and a significant part of the relative U.S. decline is a result of the eurozone exchange rate effect. In 2000, U.S. and EU exports were close to parity, while by 2010 EU exports were more than 50 percent larger. EU global exports of manufactures to non-members grew by 117 percent, from $667 billion to $1,449 billion, while U.S. exports were up by only 45 percent, from $649 billion to $944 billion. Even more disturbing were the increases in the trade imbalances. The EU surplus in manufactures quintupled from $51 billion in 2000 to $255 billion in 2010, while the U.S. deficit rose from $319 billion to $425 billion.

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The big question is what lies ahead, and the outlook is uncertain. The impact on U.S. export competitiveness would be very different if the eurozone holds together in current form through a continued policy of financial bailouts for southern tier members, compared with a eurozone exit including Italy and Spain. The first alternative was reconfirmed at the December 8-9 EU summit, with commitments to strengthen fiscal disciplines and provide financial bailouts. The measure of success will not be statements by senior officials, but interest rate differentials among eurozone members for sovereign debt. In any event, a successful outcome would take at least a couple of years, during which time the eurozone export competitive advantage would continue or grow, especially if the euro were to decline further relative to the dollar. Some observers, in fact, advocate such a decline—perhaps by 20 percent—to help reduce southern tier trade deficits at the expense of third countries.[1] Most of the eurozone's competitive adjustment, however, will have to take place within Europe, since two-thirds of EU trade in manufactures is among EU members.

The second alternative of a market-driven eurozone exit for most of the southern tier is far less clear, including the trade impact on third countries. There would be serious disruption at the outset, likely leading to a eurozone recession, which would mean a large decline in eurozone imports. The medium- to longer-term effects, however, could be favorable for third country exporters. A Germany-centered northern tier euro should appreciate steadily, reducing the current eurozone competitiveness advantage. French exporters could be especially hard hit, including for trade with former southern tier members whose currencies would have declined sharply to the euro. But much would depend on how eurozone governments react. One policy response could be to engage in protracted, large-scale official purchases of foreign exchange by the European Central Bank to stem the rise of the euro, a practice censured by the IMF as currency manipulation to gain an unfair competitive advantage in trade. And if that happened, what would the United States do?

U.S. exporters of manufactures need to stay tuned to the evolving eurozone financial crisis and how this impacts their competitiveness in global markets. It is an important interest that has been ignored in official discussions and is worthy of more serious consideration.

1 See Martin Feldstein, "Weaker euro will help solve Europe deficit woes," *The Financial Times,* December 19, 2011, www.ft.com/cms/s/0/985821ea-27f3-11e1-a4c4-00144feabdc0.html#axzz1hqXZFfOf (subscription required).