Opinion: Fundamentals of trade being ignored

By Jerry Nickelsburg

Every American knows that if you want to spend more than you earn, you either must liquidate some assets or you must borrow. And if you have been borrowing a lot, stopping will result in much less consumption.

Which is why it boggles the mind that experts in Washington, D.C., including the president's economic advisor Peter Navarro, fail to understand this fundamental principle as it applies to tariffs and border taxes. What they advocate—tariffs, currency adjustments, and other protectionist measures—is no different from Sisyphus pushing a rock up the hill only to have it roll back on top of him.

Trump's protectionists believe that by closing the trade gap and bringing manufacturing back, the U.S. will grow. Navarro's argument was presented in a Trump policy paper written with Wilbur Ross, "Scoring The Trump Economic Plan."

"Suppose the U.S. had been able to completely eliminate its roughly $500 billion 2015 trade deficit through a combination of increased exports and decreased imports rather than simply closing its borders to trade. This would have resulted in a one-time gain of 3.38 real GDP points and a real GDP growth rate that year of 5.97 percent."

This is so far off the mark that it begs explaining why.

Trump claims China is a currency manipulator. Let's suppose he convinces China to increase the value of the yuan. Presumably a yuan of higher value would make American goods less expensive for Chinese and Chinese goods more expensive for Americans. And a tariff on Chinese goods would presumably make them more expensive, discouraging imports. But trade’s realities would complicate those plans.

China’s purchases of American goods and services are mostly airplanes, machinery, earth-moving equipment, food, scrap, and education. Will the Chinese buy more airplanes if they are less expensive? Perhaps, but not many; it’s hard to integrate airplanes into an airline. Earth-moving equipment? That depends much more on China’s infrastructure needs—and not that much on Caterpillar’s price. Food? Yes, the Chinese will buy more, but that in turn will drive up food prices for Americans.

The point: It would take a very large increase in prices to bring trade back in balance from the Chinese side.

But couldn’t we sell consumer goods to Chinese households that they do not as yet buy? Yes, but in practice, for Chinese households to buy more goods, they would have to reduce their savings. That won’t be easy. China does not have the social safety net of the United States. So Chinese families save for retirement, to care for their parents, and to pay for their child’s education, and marriage. No matter how cheap North Carolina furniture is in Shanghai, Trump is trumped by the prospect of a grandchild.

What, you ask, about the U.S. purchases of Chinese goods? Yes, were the yuan to appreciate, these goods would become more expensive and we would purchase less. But a rise in the yuan would make textiles, toys, and electronics from Malaysia, Vietnam, Indonesia and Bangladesh—all countries with lower labor costs than China—more attractive. We would not close the trade deficit—we would just make U.S. consumers pay to cover the costs of moving factories into Southeast Asia.

Simply put, tariffs or currency changes are only going to produce marginal changes to the trade deficit because you cannot tweet away the fundamental problem: Americans do not save enough.

U.S. households on average save a bit over 5.5 percent of their disposable income. Add corporate savings and tax collections, and you have 18 percent of GDP available for investment and government spending. Investment accounts for most of that 18 percent—approximately $3.1 trillion. The rest is government.

And the rest is not enough to pay for all federal purchases and transfers. In fact, the U.S. is more than $400 billion short annually of the money it needs for federal spending. Where do we get that money? From people who sell more than they consume—like the Chinese. If we didn't have a trade deficit, we couldn't cover our spending.

Remember Navarro's argument. He says that economic growth will solve our problems—and cover the deficit. To achieve an additional $1 trillion of private saving to cover a $1 trillion deficit by 2023, GDP would need to double. That would require a sustained growth rate of 10.2 percent. Ludicrous.

Is there another way? Yes, you could, like Argentina, raise tariffs to make imports prohibitively expensive, disrupting globally dependent industries and sending the economy into a tailspin.

Appropriate economic policy is to institute long-term reforms boosting domestic saving and reducing the federal deficit. Bellicosity and tariff mongering are not long-term reform. They are an exercise in futility.

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