In our recent issues of *Sinology*, we explored the reasons why trade—including trade with China—is good for most American workers, consumers and companies. We explained that American manufacturing is already great (with output at close to record levels), and that the loss of manufacturing jobs has been primarily due to improvements in productivity, not competition from imports.

The problem is that a small minority of workers always bears the brunt of labor market volatility, including that caused by imports from China. To assist those “left behind,” we should avoid the temptation to focus on protectionism—which would not bring back lost jobs—and instead create programs to directly aid those who have lost employment due to technology and trade.

In this final installment of our three part series on Trump, Trade & China, we will expand on that discussion by explaining why focusing on the U.S. trade deficit will not help displaced workers, as that deficit is determined by balances between saving and investment, rather than by trade policy. The trade deficit also has little impact on employment.

**TRUMP, TRADE & CHINA—PART III**

For politicians who believe that trade is a zero-sum game, running a trade deficit is a losing score. This may be why President Donald Trump declared the U.S. trade deficit “is not some natural disaster” but a “politician-made disaster” during his campaign run. Converting the U.S. trade deficit into a surplus appears to be a key motivation behind President Trump’s desire to renegotiate or abrogate many trade agreements.

Some of Trump’s advisors have argued that the decline in U.S. manufacturing employment has been caused by the U.S. trade deficit (which means the U.S. imports more than it exports). Economists usually discuss this issue in terms of the current account balance, which covers imports and exports of both goods and services (as well as net income and transfers from aboard, although these are a small fraction of the total).

The U.S. has run a current account deficit every year since 1992, because the value of imported goods and services has been larger than the value of exports of goods and services. But this has not caused an increase in U.S. unemployment. In fact, the unemployment rate has been relatively low during times when the U.S. current account deficit has been relatively large. For example, the deficit hit record levels of about 5% to 6% of GDP during 2004 to 2006, but the unemployment rate was only 4% to 5%. In contrast, when the deficit was only about 1% of GDP during 1990 to 1993, the unemployment rate was between 6% to 7%.
Running a significant current account surplus (meaning the value of exports was greater than the value of imports) did not protect manufacturing jobs in Germany and Japan.

Germany ran a large current account surplus in recent years, ranging from about 5% of GDP in 2004 to almost 9% of GDP in 2015, but the manufacturing share of total employment continued to shrink during that time, from 23% to 17%.

Similarly, Japan ran a significant current account surplus from 2000 (almost 3% of GDP) to 2010 (about 4%), but the manufacturing share of total employment fell to 17% from 21%.

That data supports former Fed Governor Ben Bernanke’s statement that “the existence of a trade deficit or surplus, by itself, does not have any evident effect on the level of employment.”

The reason for this is that these “deficits are not caused by either U.S. or foreign trade policies. Rather, they are determined by the balances between saving and investment in the United States and in other countries and the effects of those balances on international flows of capital. The major changes in the U.S. trade deficit since 1970 can be traced to three primary sources: a long decline in saving as a share of gross domestic product (GDP) that began in the mid-1950s and accelerated in the 1980s, fluctuations in the business cycle, and relatively
attractive investment opportunities in the United States in the 1990s,” according to the non-partisan Congressional Budget Office (CBO).

“Trade policy normally has little if any effect on the trade deficit because it does not affect saving and investment,” the CBO explains, because:

“When a country experiences an economic boom, its investment typically rises faster than its saving, so its current-account surplus declines (or its deficit increases). During a recession, investment typically falls faster than saving, so the current account surplus increases (or the deficit declines). Similarly, aggregate demand (including that for imports) increases during an economic expansion and falls during a recession. In line with that typical course of events, the U.S. current-account deficit peaked in the mid-1980s when the U.S. economy was in an economic boom, declined to near zero in the early 1990s (actually becoming a slight surplus in 1991) when the country was in recession, and has increased substantially since then in line with the current prolonged economic expansion.”

The following chart illustrates this point: over time, when Americans saved more (i.e., the gross savings/GDP ratio was higher), the current account deficit was smaller.

Figure 3. CURRENT ACCOUNT BALANCE AND GROSS SAVINGS AS % OF U.S. GDP

And the next two charts illustrate that this principle has held true in Germany and Japan: higher savings rates have been correlated to higher current account surpluses (savings rates in those countries have been much higher than in the U.S.).

Figure 4. GERMANY’S CURRENT ACCOUNT BALANCE AND GROSS SAVINGS AS % OF GDP
It is important to note that this relationship between saving and investment and a country’s current account balance is a principle of economics that has long been endorsed by almost every economist, regardless of political affiliation.

For example, Martin Feldstein, who was President Reagan’s chief economic advisor for several years, explained that:

“A country’s trade balance is just equal to the difference between the amount that it saves and the amount that it invests. When a country saves more than it invests, it has a surplus of output that can be exported to the rest of the world. Conversely, when investment in plant and equipment, in housing and in inventories exceeds the amount that is saved by households, businesses and government, the extra investment requires an inflow of resources from abroad.”

And, Feldstein, a prominent professor of economics at Harvard, adds, “The advantage of this explanation is that the basic relation—that national saving (net of the budget deficit) minus national investment equals exports minus imports—is neither an economic theory nor an empirical generalization, but an accounting identity.”

Greg Mankiw, another Harvard economics professor who was senior economic advisor to President George W. Bush, says that “the trade deficit is not a problem in itself but is a symptom of a problem. The problem is low national saving.”

Mankiw adds that:

“… in reality, trade deficits are not a threat to robust growth and full employment. The United States had a large trade deficit in 2009, when the unemployment rate reached 10 percent, but it had an even larger trade deficit in 2006, when the unemployment rate fell to 4.4 percent.

Rather than reflecting the failure of American economic policy, the trade deficit may be better viewed as a sign of success. The relative vibrancy and safety of the American economy is why so many investors around the world want to move their assets here. (And similarly, it is why so many workers want to immigrate here.)”

Mankiw also has a strong opinion about bilateral trade deficits, calling them “a rather meaningless statistic.” In his popular macroeconomics textbook, Mankiw describes how another economist, Robert Solow, once explained the irrelevance of bilateral trade balances: “I have a chronic deficit with my barber, who doesn’t buy a darned thing from me.” But, Mankiw writes, “that doesn’t stop Mr. Solow from living within his means, or getting a haircut when he needs it.”
Wilbur Ross, President Trump’s Secretary of Commerce, seemed to agree. Several years ago, he said, “I think that it’s total political nonsense, all the China bashing. The trade deficit we have with the rest of the world is almost equal to the trade deficit we have with China, so what’s the big deal about China?”

In January 2017, however, Ross took at different approach when speaking at his Senate confirmation hearing. “China is the most protectionist country of very large countries,” he said.

Ross’ comments echoed President Trump’s recent complaint that China is “taxing us heavy at the borders when we don’t tax them.” But, according to the Office of the U.S. Trade Representative, “China reduced tariffs on goods of greatest importance to U.S. industry from a base average of 25% (in 1997) to approximately 7%, while it made similar reductions throughout the agricultural sector.”

One important aspect of the U.S. trade deficit with China is that it largely reflects that Chinese firms have taken market share away from other exporters, especially Japan. In 1991, Japan accounted for 66% of the total U.S. trade deficit, while China accounted for 19%. By 2016, China’s share of the U.S. deficit rose to 47% while the Japanese share shrank to only 9%.

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**Figure 6. TARIFF RATE OF MANUFACTURED PRODUCTS, MOST FAVORED NATION, WEIGHTED MEAN**

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**Figure 7. SHARE OF U.S. TRADE DEFICIT IN GOODS**

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Almost 75% of the total U.S. trade deficit with China emanates from the electronics and textile manufacturing sectors,” according to Oxford Economics. “In both of these industries, China’s growing market share in the United States actually represents China’s displacement of imports from other countries: China has been squeezing out traditional apparel manufacturers such as Mexico, Hong Kong, and Taiwan. In electronics, Oxford Economics’ calculations show the volume of imports of computers and electronic products from Japan have barely grown since 2000, while South Korean exporters have lost market share.”

The relationship between savings and investment also helps explain why protectionist measures, such as higher tariffs on imports, will neither reduce the U.S. trade deficit nor boost U.S. manufacturing employment.

High tariffs would probably result in higher consumer prices in the U.S., but if they did succeed in reducing imports, that would squeeze the supply of U.S. dollar in global currency markets, leading to a stronger dollar. The stronger dollar would make American exports more expensive and U.S. imports cheaper, so the U.S. current account balance would return to its original level, which was in line with the balance between savings and investments.

Concluding Comments

Over the course of a discussion in this issue of Sinology, as well as in the first and second installments of our three-part series, we have tried to explain that trade is not a zero-sum game, and that trade deficits are not a scorecard. We reported that trade deficits are not a threat to economic growth and full employment, and that a trade deficit can in fact be seen as a reflection of a sign of success.

We made the case that trade—including trade with China—is good for most American workers, consumers and companies; that American manufacturing is already great (with output at close to record levels); and that the loss of manufacturing jobs has been primarily due to improvements in productivity, not competition from imports.

The problem is that a relatively small number of workers always bears the brunt of labor market volatility. In our search for policies to assist those people, we must avoid the temptation to focus on trade deficits and protectionism—which would not bring back lost jobs—and instead work toward creating programs which will directly help those who have lost employment due to technology and trade, and which will better educate our future workforce.

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