Balancing Trade Is Not Protectionism

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By MICHAEL P. COLLINS, Author, *Saving American Manufacturing*

Let me begin this article by describing this economic anomaly called a trade deficit. When imports and exports of a country are in balance, all trading countries benefit. Each country specializes in what it does best — exchanging its most competitive products for products it could not produce as cheaply as the trading country. When trade is in balance, all countries benefit and living standards rise in each benefitting country.

Trade deficits must be financed. A country simply cannot have a trade deficit unless private or government investors are willing to finance it. In 2007, we exported $1.645 billion and imported $2.346 billion worth of imports, with a deficit of -$700 billion. To finance this deficit, our trading partners (particularly China) loan us the money to pay for the deficit by buying U.S. bonds and other government assets so that we buy more of their imports.

The trade deficit since 1971 has added up to $7.5 trillion with $6.5 trillion in just the last 20 years. Normally trade deficits are self-correcting, because as the deficit grows, the country’s currency begins to decline in price in the world market. This makes exported goods less expensive and foreign goods more expensive, and trade is supposed to balance itself.

In the case of America, this balance is not happening because several of our trading partners have figured out how to keep the dollar value high and their currency low, so that they can continue to increase their imports and keep the U.S. in a permanent and artificial trade deficit. They do this by manipulating their currency values. This manipulation is called mercantilism and is illegal under World Trade Organization (WTO) rules.

So, just how threatening is this problem compared to our other financial problems?

Warren Buffet says, “The U.S. trade deficit is a bigger threat to the domestic economy than either the federal budget deficit or consumer debt, and could lead to political turmoil.” If Buffet is correct, then why are the politicians spending all of their time arguing about the federal deficit and saying very little about the trade deficit? (More on this later.)

Most of our largest trading partners, like Germany, Japan, Switzerland and China, do not have trade deficits because they make sure they always have trade surpluses. If deficits are not bad, as Milton Friedman always claimed, then why don’t other countries run big trade deficits?

One of the rationales always given to support the notion that running a deficit is good is the claim on how much the American consumer is saving because of cheap imports. However, saving on cheap imports has not been enough to stop the decline of middle-class living standards. The availability of cheap imports helps increase consumption for the short term.

There are always going to be articles touting the advantages of free trade and exports for some sectors of our economy, like agriculture and some high-tech products, and for corporate America. For certain companies, continuing to run trade deficits as a “fre- market policy” makes a lot of sense. Just as in the subprime financial disaster, there were many people who got rich and would like to do it again.

Who Are the Losers?

As I see it, the losers in the ongoing policy of financing trade deficits are small and midsize American manufacturers, manufacturing workers, taxpayers, environmentalists and the country in general. Continuing to run trade deficits has led to de-industrialization and the loss of millions of manufacturing jobs. Government analysts now admit that the North American Free Trade Agreement (NAFTA) cost the U.S. 879,280 jobs. Since the entrance of China into the WTO and offshoring, we have lost another 2.5 million manufacturing jobs. This loss of jobs is directly the result of our free-trade policy.

Trade deficits have also had a serious impact on wages, particularly for those people without college degrees (who are 75 percent of the workforce). “Growing trade deficits eliminate the good jobs and reduce average wages in the economy. Most economists now acknowledge that trade is responsible for 20 to 25 percent of the increase in income inequality, which has occurred in the U.S. over the last two decades.”

The potential losers, if our house-of-cards trade deficit problem cannot be sustained, are our 87 trading partners. Many of them are running surpluses and have gained a lot by trading with the U.S. To continue to allow our trading partners to trade with us, while we absorb the deficits and they enjoy the surpluses, is absolutely insane.

They, like the heroin addict, are relying on the U.S. to be able to finance this trade deficit ad infinitum. But if we can't, and fall into some kind of economic black hole, they are all going to fall with us. One would think that it is in everyone's best interests to see America balance its trade.

Who Are the Winners?

The winners are the multinational American companies who aggressively invest in production all over the world. They build plants in other countries to supply the foreign market, but they also ship cheap products back to the U.S. The rights of these investors (multinational companies) always take precedent in bilateral and multilateral negotiations.

By spending a lot of money lobbying through the Chamber of Commerce and other pro-trade-deficit groups, they have kept Congress from passing any law that would upset the Chinese lobby. Why? Because these companies have big investments in China and do not want to upset the Chinese people and risk these investments.

Multinational companies are very comfortable with the Chinese practice of manipulating their currency because it makes their exports back to the U.S. cheaper. The last reason that the trade deficit is not a problem for the multinationals is that we, taxpayers, finance the deficit for them.

What Are the Politics?

There is a bill that has passed the Senate that will try to force China to quit manipulating its currency. This is not protectionism because manipulating currency is illegal under WTO rules and China is a member of the WTO. All we want is to level the playing field and to stop currency manipulation so that all nations (including America) have a chance at balancing their trade. But making no effort to stop currency manipulation and continuing to export by financing huge deficits is the road to disaster.

John Boehner, Republican Speaker of the House, says that any laws like the currency law passed by the Senate are dangerous and could lead to a trade war. His approach is to kick the can down the road, and request the Obama administration to say whether they would veto or support the bill before a House vote.

Surprisingly, when President Obama was campaigning for the Presidency, he said he would not allow the Chinese to continue to manipulate its currency. But in recent years, he has become ambivalent about the currency manipulation issue. Robert Kuttner of *The Huffington Post* says that Treasury Secretary Geithner has repeatedly refused to formally cite China as a currency manipulator, which should compel the U.S. government to pursue sanctions.

Alan Tonelson writes in *American Economic Alerts* that "the President's recent remarks strongly, if reluctantly, hinted at a White House veto." This is a very strange reversal of thinking by the President, and one can only wonder how much the multinational lobbyists have influenced the administration in terms of the 2012 election.

But regardless of which side of the issue you favor, the issue isn't about trade, it is about financing deficits. Even though this practice has gone on for 30 years, I will make the case that it is unsustainable and very risky. This is like trying to sustain a heroin addiction. The addict likes the high from the injection so much that he rationalizes that somehow he will always come up with the money to buy heroin in the future.

In macro economics there is no free lunch — benefits are always accompanied by costs. For instance, what if, for some reason, there is a run on the dollar and the value of the dollar results in a currency crash? Hence the value of all of the bonds and treasury notes will also go down in value and the Chinese are holding $2.3 trillion of U.S. assets.

Interest rates would rise, affecting banks, mortgage loans, and the money borrowed for deficits and bailouts.

Or what if something politically happens between the U.S. and China, and China decides to punish us by cutting off money? I think we built a financial house of cards that could tumble down just as the subprime bubble crashed in 2007. For many reasons, our ability to continue to play the deficit game is unsustainable.

As Congress slowly addresses the Chinese currency issue, you will hear more people sounding the alarm of a potential trade war with China. The fact is that we are already in a trade war with China and we are losing. China has attacked us on three fronts: currency manipulation, counterfeiting, and stealing our technologies, tariffs and subsidies that favor them. Politically, we probably can't and won't do anything about the latter two problems, but we certainly have a shot at reducing currency manipulation through the WTO. This is not protectionism; it is a legal effort to do something about balancing our trade like every other country.

David Frengel, an executive at Penn United, a midsize manufacturing company that has worked hard to get the currency reform bill approved, summarizes the problem expertly. He says, "We should not concede the free-trade label to the opponents of trade reform. We are the free traders because we are the ones that want to see the rules of free trade enforced. Those that oppose the enforcement of free-trade rules are really protectionists — they are protecting the protectionism that they enjoy in the mercantilist nations like China."

Michael P. Collins is the author of the book Saving American Manufacturing*. You can find more related articles on his website via* www.mpcmgt.com *[1].*

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