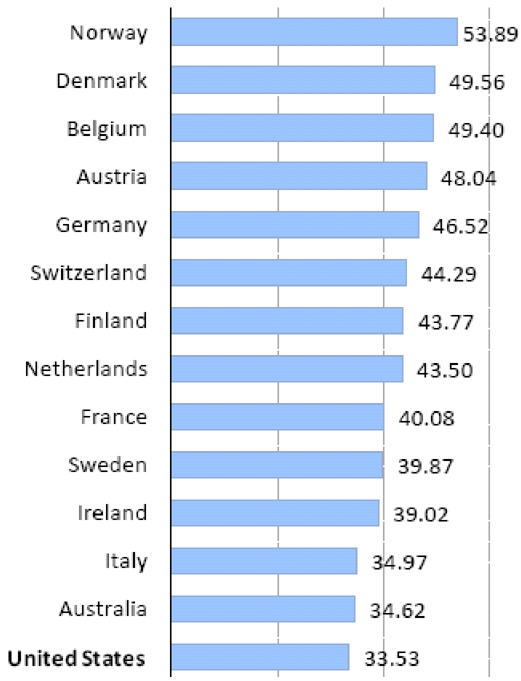
Mitchell's Musings 3-14-11: Trade Again

From time to time, I muse about international trade and particularly the U.S. trade deficit. Two events brought this issue back to my attention. The first was a release by the U.S. Bureau of Labor Statistics (BLS) of its series on hourly compensation costs in manufacturing (wages, benefits, and payroll taxes) in various countries as compared with the equivalent American compensation cost. The latest data are for 2009. For reasons I will explain below, the chart below covers only countries whose pay level was *higher* than the U.S. level.



As can be seen above, the U.S. manufacturing pay level was $33.53 per hour in 2009. In contrast, Norway – at the top of the chart – had a pay level of $53.89. These figures are in U.S. dollars at exchange rates of 2009, unadjusted for living costs in the various countries. (For purposes of cost competition in international markets, local living costs are irrelevant.)

Now you might assume that these countries, with their higher levels of pay, would be at a disadvantage in cost competitiveness relative to the U.S. and that the U.S. would therefore run a trade surplus with them. They are all developed countries with access to the same technology as the U.S. In fact, in aggregate, the American trade balance with these countries was negative to the tune of -$50 billion.[1] The U.S. trade deficit in total in 2009 was a little over -$500 billion so countries with pay higher than the U.S. nonetheless accounted for about 10% of the deficit.

[1] The U.S. ran surpluses with Belgium, Switzerland, the Netherlands, and Australia in 2009. Trade balance data are available from the U.S. Bureau of the Census at http://www.census.gov/foreign-trade/balance/index.html. The BLS release is at http://www.bls.gov/news.release/pdf/ichcc.pdf .

China, in 2009, accounted for about 45% of the deficit. So, yes, there is something going on with regard to trade with China. The big candidate there is the artificial exchange rate. But what about the other countries?

As international economists will point out, trade imbalances reflect differences in national saving and investment rates. The U.S. has been a deficient saver for many years and has borrowed from the world to finance its trade deficit. The indirect labor market impact has been to shift jobs out of manufacturing and into retail. That shift has distorted the labor market and tended to erode good jobs.

That brings me to the second event of last week that brought this topic to mind. The UCLA Anderson Forecast presented its quarterly outlook for the U.S. and California. However, its conferences always have an additional theme and in this case it was bringing back manufacturing. To paraphrase the observation of Prof. Edward Leamer - who heads the forecasting project - what the U.S. needs to do now is turn its shopping malls into factories.

Of course, that shift is easier said than done. It is fine to point out that the trade deficit is ultimately unsustainable, that "eventually" the world will grow weary of financing the trade deficit, and that something will then happen. In the words of President Nixon's chief economist Herb Stein, "That which cannot go on forever must come to an end." However, the world has grown used to the U.S. playing Keynes in recessions and generally providing jobs for everyone else. Both the U.S. and the world need weaning from their bad habits.

In prior posts, I have suggested that the U.S. needs to be proactive in this regard. I have noted the long-neglected Warren Buffett plan for forcing resolution the trade issue.[2] In the short term, it would help with the aftermath of the Great Recession. In the longer term, it could avert finding out just how that which cannot go on forever will come to an end. That end could be through another very unpleasant financial crisis, this one situated in currency markets rather than housing/mortgage markets, but with potentially the same effect. Making the shift now to balanced trade will avert the pain later.

[2] See http://employmentpolicy.org/topic/10/op-ed/how-solve-our-trade-mess-without-confrontation-china