Mitchell's Musings 7-2-12: Made in USA or Not

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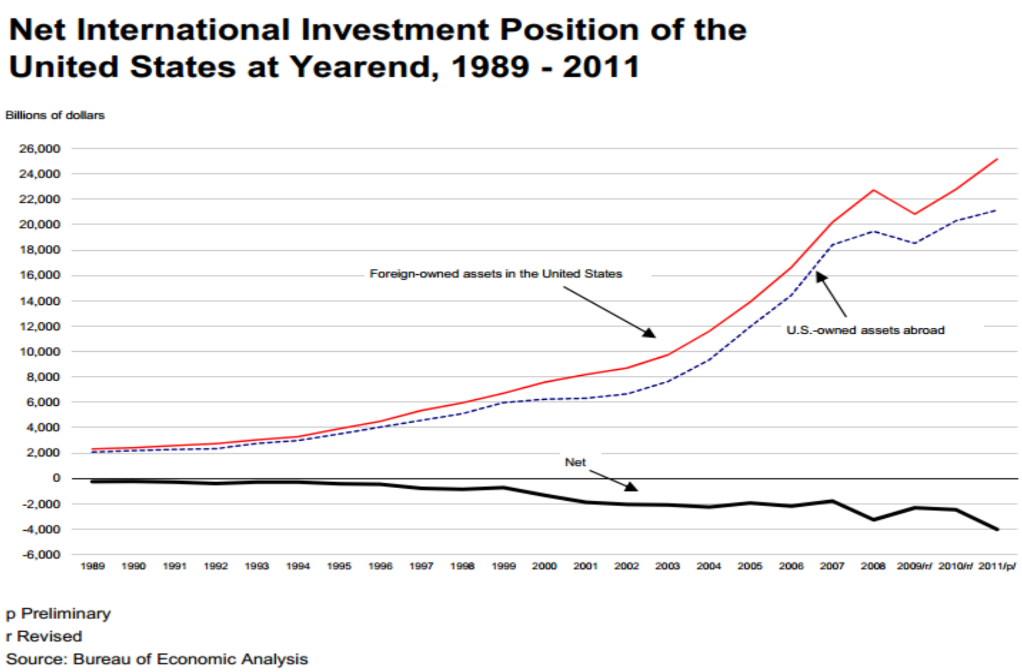
In this election season, we are guaranteed to hear much about the federal budget deficit. Oddly, the other deficit, the "trade" – really net export - deficit, seems to be entirely neglected.[1] I say "oddly" because in a period of high unemployment, there is concern about jobs. In principle, government could take direct action and create jobs – but in fact a combination of political gridlock at the federal level and the fact that state and local governments are ultimately budget-constrained means that there is unlikely to be more public job creation. Indeed, recent trends at the state and local level are in the other direction.

When a household or a country continually spends more buying goods and services than it is earning, eventually its net assets are depleted and net debt piles up. How long a household or a country can go before something brings the process of living off borrowing to a halt varies. But if the net debt is to be repaid at some point, the person or household or country must reverse course and spend less on goods and services than is earned. All of this is arithmetic, not high-powered theory. As the chart below shows, because the U.S. has been running a large net export deficit for many, many years – in effect borrowing from the rest of the world to support its lifestyle - the U.S. has become the world's largest debtor.[2] And as is well known, the U.S. has enjoyed more leeway in that regard because the dollar for historical reasons is an international currency.



[1] "Trade" technically refers only to goods exports and imports and omits services.

[2] Source of the chart: http://www.bea.gov/newsreleases/international/intinv/2012/pdf/intinv11.pdf.

There is some connection between net export deficits, increasing international debt, and the federal budget deficit and debt but it is a loose connection at best. So the two deficits should not be confused or thought to be mechanically related. One of the assets held by foreigners, including official foreigners such as central banks, is U.S. Treasury debt. Official foreigners hold about one fifth of the gross international debt of the U.S. U.S. government liabilities are also about a fifth of gross international liabilities of the U.S. Thus, the federal budget deficit is part of the story behind the growth of America's net international debt – but not most of the story. Federal deficits are a form of negative saving (dissaving) that reduces total national saving from all sectors and contributes to the net export deficit in that way. But again, "contributes to" is not the same as being the sole cause or even the primary cause.

Under current circumstances there is a much more direct jobs link to the international sector than to the federal budget. If we were in a period of full employment, but were running a net export deficit, the impact of the international sector would not be on the *number* of jobs – by assumption already at the level associated with full employment – but on the *composition* of jobs. In broad terms, since a significant proportion of exports and imports is manufactured products, a bigger net export deficit would mean fewer jobs in manufacturing but more jobs in other non-trade sectors such as various services, retail, etc.

With a major departure from full employment, such as we now are actually experiencing, the impact of an *improved* net export balance would be more jobs total – mainly in manufacturing – rather than just a reshuffling of a fixed number of jobs across different sectors. About two-thirds of U.S. good exports and close to three quarters of goods imports are manufactures. Compared to trade in goods *and services*, the manufacturing ratios for exports and imports are on the order of 60% and two thirds.[3] The current net export deficit is about 4% of GDP. So a back-of-the-envelope calculation would suggest that if the net export deficit were brought to zero, labor demand would increase by about 4% and something like 60% of the added demand would go to manufacturing. Such a shift would likely raise manufacturing labor demand by over one fourth – a lot! - since nowadays the employed labor force in manufacturing is roughly a tenth of total employment.[4] You can quibble with this loose estimate and refine it in many ways. But it would be hard to deny that improving the net export balance would have a big positive impact on U.S. manufacturing.

Despite the key issue of jobs in today's economy, there has been great reluctance by policy makers and political leaders to examine the international trade issue in a macro sense. Perhaps there is fear on their part of being branded a protectionist. Perhaps the idea has become prevalent that whenever globalism (whatever that word means) is operating, mere national policy cannot influence outcomes. While there

[3] I used 2012 export and import data through April for calculating the proportions. Source: http://bea.gov/newsreleases/international/trade/2012/pdf/trad0412.pdf.

[4] On a national income account basis, manufacturing full-equivalent employment was a little over 9% of total in 2010 (the 2011 revisions are not yet available). See http://www.bea.gov/scb/pdf/2011/08%20August/NIPA_Section6.pdf.

is recognition that exchange rates and an overvalued dollar may be part of the story behind the U.S. net export deficit, it seems to be assumed that there is little to be done on that question. Or it is assumed that somehow the problem will resolve itself.

Indeed, the last assumption seems to be in vogue today. The limited appreciation of the yuan relative to the dollar allowed by Chinese authorities and indications that Chinese wages are rising are seen as forces moving towards solving the problem. But moving towards a solution is not the same as arriving at a solution in a timely manner. Unfortunately, the needed *pace* of those developments that are said to be moving towards a solution and some projected date when the solution will finally arrive are never specified. The U.S. needs balanced trade simply to stop its net international debt from rising. In fact, it needs a net export surplus to begin paying off its net debt. When these events will occur is never indicated by those who are content with the assumption that things are moving in the right direction.

What happens as a result of avoiding the larger trade issue is that its symptoms are addressed erratically in a micro sense. For example, a recent Commerce Department decision proposes anti-dumping duties on Chinese-made solar panels.[5] But attempting to go product by product to resolve the trade problem is not a solution. Vague export promotion efforts also have little impact. Ratification of this or that trade treaty has little effect. In view of federal inaction, there is temptation for state and local politicians to respond. However, dealing with the national trade problem at the sub-federal level is not practical.[6]

Ultimately, there is no point in stewing about "What's the Matter with Kansas?" if no political leaders are addressing the trade issue effectively. That phrase – the title of a book and movie – has been used to suggest that white working-class voters increasingly and mysteriously are voting against their economic interests, a thesis that has been challenged.[7] Neither political party has focused on the trade imbalance and its impact on the labor market for such workers and on manufacturing. So neither one is particularly focused on the interests of those voters. As a result, they swing back and forth between the parties (determining the outcome of close elections) in the hopes someone someday will respond to their deteriorating job prospects.[8]

In short, trade seems to be a non-topic within both the left and right segments of our polarized political leaders. And Kansas, if you are wondering, is a bit above the national average in its proportion of

[5] http://www.bloomberg.com/news/2012-05-17/u-s-imposes-anti-dumping-duties-for-chinese-solar-imports.html.

[6] One proposed California law, for example, would have provided a tighter state definition for a product to be labeled "Made in USA" than under the federal standard. See http://www.mercurynews.com/opinion/ci_20901680/dan-walters-californias-made-usa-bill-is-no. There have also been periodic controversies in California over purchase of foreign steel for the rebuilt Bay Bridge in the San Francisco area or about the source of light rail cars bought by local authorities.

[7] http://www.princeton.edu/~bartels/kansas.pdf.

[8] http://campaignstops.blogs.nytimes.com/2012/06/17/canaries-in-the-coal-mine/.

manufacturing workers in its workforce. No one has focused effectively on the international trade issue for manufacturing there - or anywhere else in the U.S. The real question is, what's the matter with Washington, DC?