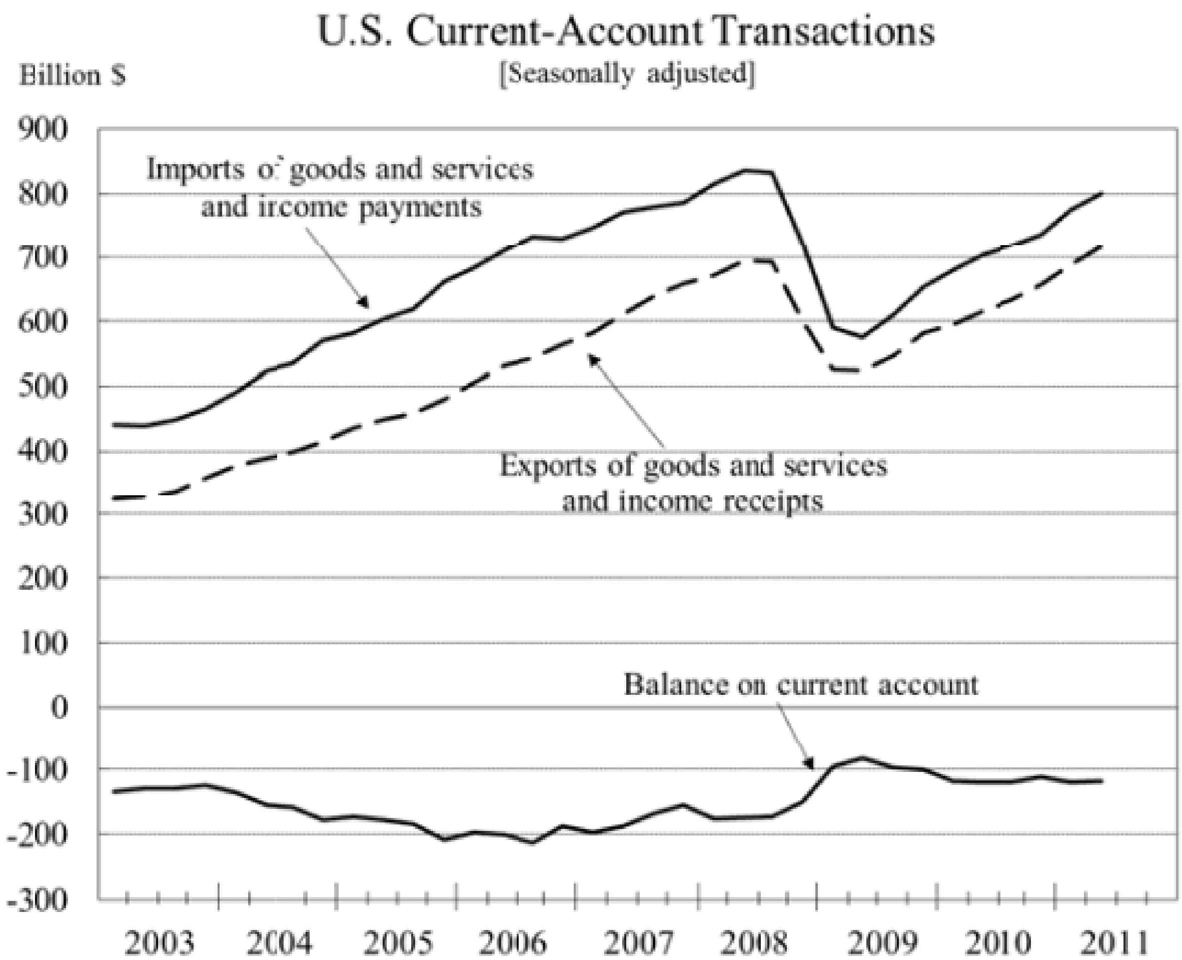
Mitchell's Musings 9-26-11: Odd Selectivity in Choosing from Buffett's Policy Buffet

This week's musing deals with what gets on the national policy agenda – or, more pointedly – what doesn't. To motivate the discussion, let's look at two charts below and on the next page and then proceed. Both charts are from press releases of the U.S. Bureau of Economic Analysis and both deal with the international element of the U.S. economy. The first chart deals with flows, the flows of goods and services exported and imported from the U.S.[1] The U.S. runs a large deficit on current account (or just on trade in goods and services). It remains large in recent years, but "improves" as a result of Great Recession (mainly because the downturn discouraged consumption of consumer goods, including foreign-made consumer goods).

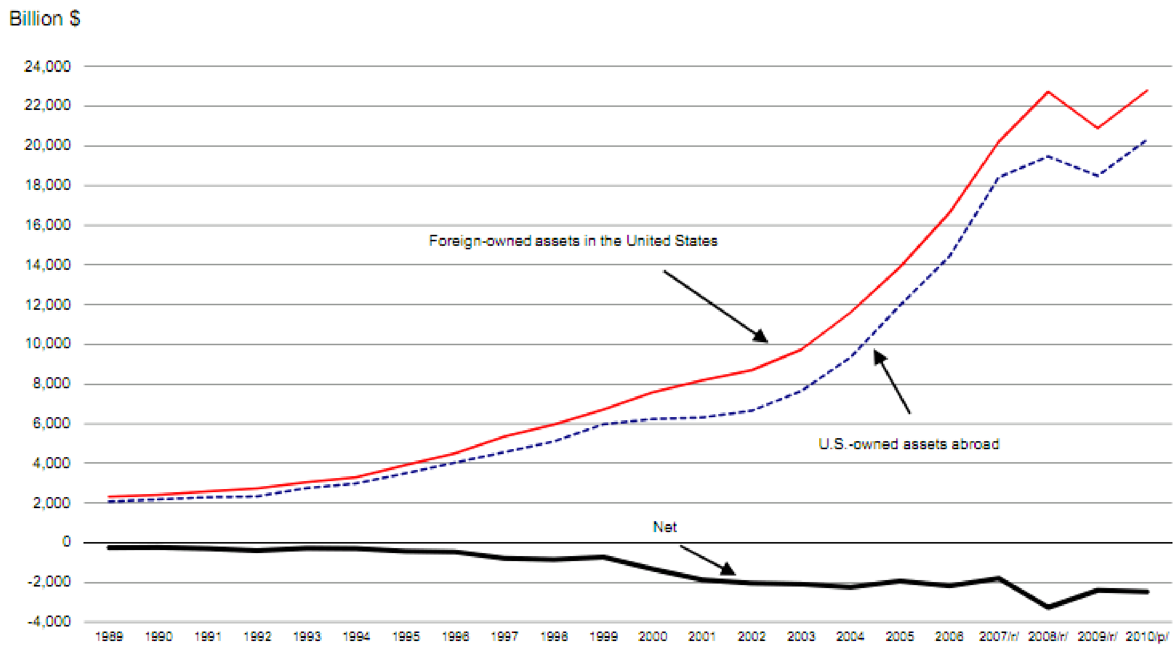


From: http://www.bea.gov/newsreleases/international/transactions/2011/pdf/trans211.pdf

[1] As noted on the chart, the data graphed include income payments and receipts. If we confined the chart just to exports and imports, it would look much the same.

The second chart deals with a stock rather than a flow. It shows what can be thought of as U.S. net debt to the world. If a country (or a household) continues to buy more from the outside than it sells – as the U.S. has been doing for a very long time – it must inevitably run down any net reserve of previously-accumulated assets and eventually go further and further into net debt.[2]

Net International Investment Position of the United States at Yearend, 1989 - 2010



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From: http://www.bea.gov/newsreleases/international/intinv/2011/pdf/intinv10.pdf

Now that these points of arithmetic and economic history have been made, let's go back to a consideration of what gets on the national policy agenda. Actually, trying to figure out how things get on the agenda is a longstanding concern of political scientists. And it's of obvious interest of lobbyists and others who want particular topics to be part of the agenda. A great deal of money is spent by interest groups on trying to push particular issues to the forefront.

One way that issues become talked about in policy circles is if famous people talk about them. And one such person is famed financier Warren Buffett, chairman of Berkshire Hathaway. Most recently, Buffett's proposal that, in a properly-functioning tax policy, his average tax rate as a billionaire should

[2] The lines of the chart also vary with fluctuations in exchange rates which cause the dollar equivalents of assets denominated in foreign currencies to vary.

not be less than his secretary's – received major attention. The proposal grew out of Buffett's op ed in the *New York Times* entitled "Stop Coddling the Super Rich," http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html, and took on the name "the Buffett Rule." Much debate has ensued, and continues to ensue, about the Rule. But clearly, the fact that Buffett said it – and did so in a major national newspaper - put the idea on the national agenda. It was widely discussed. Whether or not the Buffett Rule will ultimately influence the tax code is another matter.

Buffett's national comment on taxes was not the first time he had ventured into fiscal policy. Another notable episode occurred at the state level, in my home state California. In 2003, as a consequence of a state budget crisis, a recall campaign against incumbent governor Gray Davis was begun. It eventually led to the entrance as a candidate - and election - of Arnold Schwarzenegger to replace Davis. During the campaign, Schwarzenegger created a team of economic advisors including Warren Buffett. Buffett, however, touched the third rail of California politics – Proposition 13 – a very popular 1978 ballot initiative which drastically cut and capped local property taxes.

One feature of Prop 13 is that taxes on properties are based on the *original* sales price, not the current market value. Buffett pointed out in an interview that a property in California he had purchased long before 2003 had a very low Prop 13 assessment (and tax) while a much-less-valuable – but more recently purchased – property had a substantially higher Prop 13 assessment and tax. He also compared the tax he paid on both with what he paid on a still-less-valuable property in Omaha.[3] (Buffett paid more on his Omaha property than on either of his California properties.)

Schwarzenegger quickly distanced himself from Buffett's comments. California politicians shy away from any comments that suggest they are unhappy with Prop 13. Nonetheless, the fact that Buffett said what he said was widely reported in the news media, even outside of California. Indeed, the statement arose in an interview in the *Wall Street Journal*. So Buffett's view was placed on the agenda, much to the distress of the candidate he was supporting. If a less prominent person had said the same thing, few would have noticed.

In short, Buffett - over the years - has provided a buffet of policy opinions that can be – and often are – chosen for the agenda. But is there any topic that – even when Buffett discusses it in a major national newspaper – gets no notice? And, if there is such a topic, why is it considered either unworthy or taboo by policy makers, politicians, and the talking heads of Washington? As you might guess, there is such a topic and it is precisely the one suggested by the two charts presented at the outset of this musing: U.S. international trade.

The chronic tendency of the U.S. trade imbalance was already evident in the late 1980s. On May 3, 1987, Buffett published an op ed in the *Washington Post* entitled "How to Solve Our Trade Mess

[3] Buffett noted after the campaign that his interview – with the *Wall Street Journal* - was not completely reported. See http://wealthandwant.com/docs/Buffett_Prop13.html

Without Ruining Our Economy."[4] I have discussed this proposal and op ed in previous musings and even at academic meetings. But I am not Buffett, so no one notices.

At the time Buffett wrote his piece, there was concern about Japan (China had not yet registered as a major trading country with the U.S.) and the large surplus in trade Japan was running with the U.S. Here is a quote from the Buffett op ed:

If we were less well-off, commercial realities would constrain our trade deficit. Because we are rich, however, we can continue to trade earning properties for consumable trinkets. We are much like a wealthy farm family that annually sells acreage so that it can sustain a life style unwarranted by its current output. Until the plantation is gone, it's all pleasure and no pain. In the end, however, the family will have traded the life of an owner for the life of a tenant farmer.

The time to halt this assets-for-consumables trading is now, and it can be done. The plan I have in mind may at first sound gimmicky. In truth, it retains most free-market virtues. It neither protects specific industries nor punishes specific countries, and it should not engender trade wars. It would increase our exports and might lead to increased overall world trade. And it would balance our books without further devaluations of the dollar.

Sounds good, no? An idea from a prominent person in a major national newspaper that addresses an issue of the day! What was the plan?

We would achieve this balance by issuing what I will call Import Certificates (ICs) to all U.S. exporters in an amount equal to the dollar value of their exports. Our exporters would, in turn, sell the ICs to parties wanting to import goods into the United States. To import $1 billion of goods, for example, an importer would need ICs that were the by-product of $1 billion of exports. The inevitable result: trade balance.

In short, Buffett's plan was a voucher arrangement. Exporters would get vouchers entitling them to import an equivalent value to what they exported. They could exercise the vouchers directly or sell them in the market to others who wanted to import. But, at the end of the day, since you could not import a dollar of goods or services without a voucher with a face value of a dollar – and since the total face value of all vouchers was equal to the value of U.S. exports - the value of imports would have to be equal to the value of exports.

Like all proposals, there are complications. There would be administrative costs involved in the Buffett plan, for example. Some agency would have to verify the claimed values of exports and imports.[5] But, if you do the math, what Buffett proposed was a way of attaining the specific exchange rate (the net of the actual exchange rate and the market price of the voucher) that equates exports and imports.

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[4] https://docs.google.com/Doc?docid=0ATVLYPK7QI_4ZGNkcWtteHJfNThjNTdmY3NndA&hl=en_US

[5] Note that we already have a customs bureaucracy that examines the value of imports. And exports are policed to a degree to prevent sales of certain military-related products. But, clearly, the plan would entail more inspectors.

You might think that this proposal would have had some traction in Washington, both because Buffett said it and because it appeared in the *Washington Post*. But it never got on the agenda. The op ed came and went. DC took no notice or averted its eyes.

Was its failure to gain traction due to a fear by the DC cognoscenti of being called "protectionists"? I don't know the answer. One possibility is that, by 1987, the dollar exchange rate – which had appreciated steadily during the first half of the 1980s and had raised concerns in doing so– had reversed direction and was depreciating by 1987. Perhaps the DC opinion guardians of that era thought that the trade/dollar problem was going to resolve itself. A related possibility is that the economy had been recovering since the deep double-dip recession of the early 1980s and so the jobs-trade connection was perhaps seen as an issue of the past. But the fact is that although the exchange rate has fluctuated since 1987, the U.S. has continued to run large net export deficits. And there have been three recessions - including the Great Recession - since 1987.

From time to time, the jobs-trade issue is raised. Most recently, EPI, for example, has issued a report on estimates of job losses due to trade with China.[6] And when such reports are released, they receive some newspaper attention.[7] But no one has come up with a solution. Instead, particular industries seek protection, perhaps by filing charges of dumping. Or there is litigation at the WTO about trade in particular products. Or there are rhetorical episodes of China-bashing by politicians (as there was Japan-bashing when Buffet wrote his op ed). Such bashings create foreign policy frictions but have little impact on the underlying problem. Recall, in contrast, that Buffett argued that his plan "*neither protects specific industries nor punishes specific countries…"*

Ultimately, for the U.S. to begin repaying its net foreign debt, it will need to run a net export surplus. Just having balanced net exports would only stop the debt from increasing. In 2010, the net export deficit was about -$500 billion. So just moving to zero would be a domestic jobs/economy stimulus of $500 billion. To put that number in perspective, the President's recently-released jobs proposal – which faces strong opposition in Congress – was widely labeled in the news media as a $450 billion economic stimulus package.

So why was Buffett's proposal quickly forgotten in 1987 when it was made? Why isn't it on the agenda now - given the sorry state of the contemporary jobs market? As the King sang in the musical *The King and I*:

"Is a puzzlement!"

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[6] See http://www.epi.org/publication/growing-trade-deficit-china-cost-2-8-million/. There are many issues surrounding the making of such estimates. I am not focused on the validity of a particular methodological approach in this musing; the EPI report is simply an illustration that the trade issue is discussed – but not the Buffett plan to address it.

[7] See, for example, http://latimesblogs.latimes.com/money_co/2011/09/trade-deficit-with-china-cost-nearly-28-million-us-jobs-since-2001.html