

The mercantilist delusion

Trump's dislike for trade deficits overlooks fundamental tenets of economics

Scaling up basic logic can be hard; especially, it turns out, if you are an unusual president. Would Trump, self-proclaimed dealmaker, be willing to trade three of his golf courses, worth together, say, \$300m, in exchange for one building worth only \$100m? Would he consider that a great deal? Of course not. Yet when it comes to the US trade balance, that is exactly what he hopes to achieve.

When Trump says that trade deficits are bad, what he is really saying is that he would rather see US workers exchange more of their stuff for less from abroad. When it comes to international trade, this mercantilist delusion, an economic illogic, is spouted all too often.

It is easy to miss the obvious point if you view a country's trade balance as if it were just the difference between revenues and costs in a business. The benefit from trade is not what a country sells, but what it buys. If American workers can permanently consume German cars and Chinese electronics that cost more than American-made goods they send to Germany and China, they are getting a pretty great deal.

That a trade surplus is always favourable is a misconception. A trade deficit of, say, \$50bn, for country X to country Y doesn't represent a \$50bn loss for country X. Instead, it shows that X can consume \$50bn more of goods from country Y than it has to send in return. The major aim of trade, as Adam Smith argued, is to export as little as possible in exchange for importing as much as possible. Nothing has changed in some 250 years since Smith's day.

Rich countries like the US can afford to permanently run modest trade deficits because foreigners are willing to supply the US with surplus cash via investment or credit. The US enjoys the highest foreign direct investment in the world because, thanks to its strong economy, it has a risk-return profile that attracts foreign investors. US households benefit from this through higher consumption by way of trade.

While some industries can lose out to more competitive foreign producers when a country opens up to increase its trade, there is no link between the overall trade balance and employment, or economic

growth. Let us compare the US and the UK against Germany and Japan. All are highly developed economies. All enjoy low unemployment. And yet the US and UK, with their persistent trade deficits, tend to enjoy faster economic growth, on average, than Germany and Japan.

Trump threatens trade tariffs for countries that the US runs a trade deficit with. Thanks to the laws of economics, such measures would, in the end, prove futile. America's southern neighbour, Mexico, has become the scapegoat in this debate. But what if the US increased taxes on Mexican imports? For a time, the higher costs of Mexican goods for US consumers would indeed reduce US demand for them. But over time, the damage to the Mexican economy from weaker exports to the US would cause the Mexican peso to depreciate relative to the US dollar, offsetting the effect of the tariff and, ultimately, raising US demand for Mexican goods again.

Tariffs aimed at lowering foreign imports to protect US jobs are politically favourable, since they generate concentrated benefits for the protected workers, while spreading the much higher costs thinly across the

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whole US economy. History provides a nice example. In the 1970s, successfully lobbying efforts by the US auto industry to limit Japanese auto imports benefited Detroit's autoworkers for a while. But in the end, by blocking foreign competition, the quality of US cars began to lag behind the more efficient Japanese and European cars. The US car industry lost some of its market share as a result. Only by making US households poorer in order to reduce their demand for foreign goods could Trump rebalance US trade.

In a worst-case scenario, other countries would retaliate to US protectionism. Such tit-for-tat protection would hurt the global economy badly.

Luckily, as we learned from Trump's failed attempt to eliminate Obamacare, the US political system can hem in even the most unusual president. This materially limits the opportunity to press forward with US protectionism so that the winds of global trade can continue to blow harder than Mr Trump's windy rhetoric. ♦



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