The US Trade Deficit: Myths and Realties

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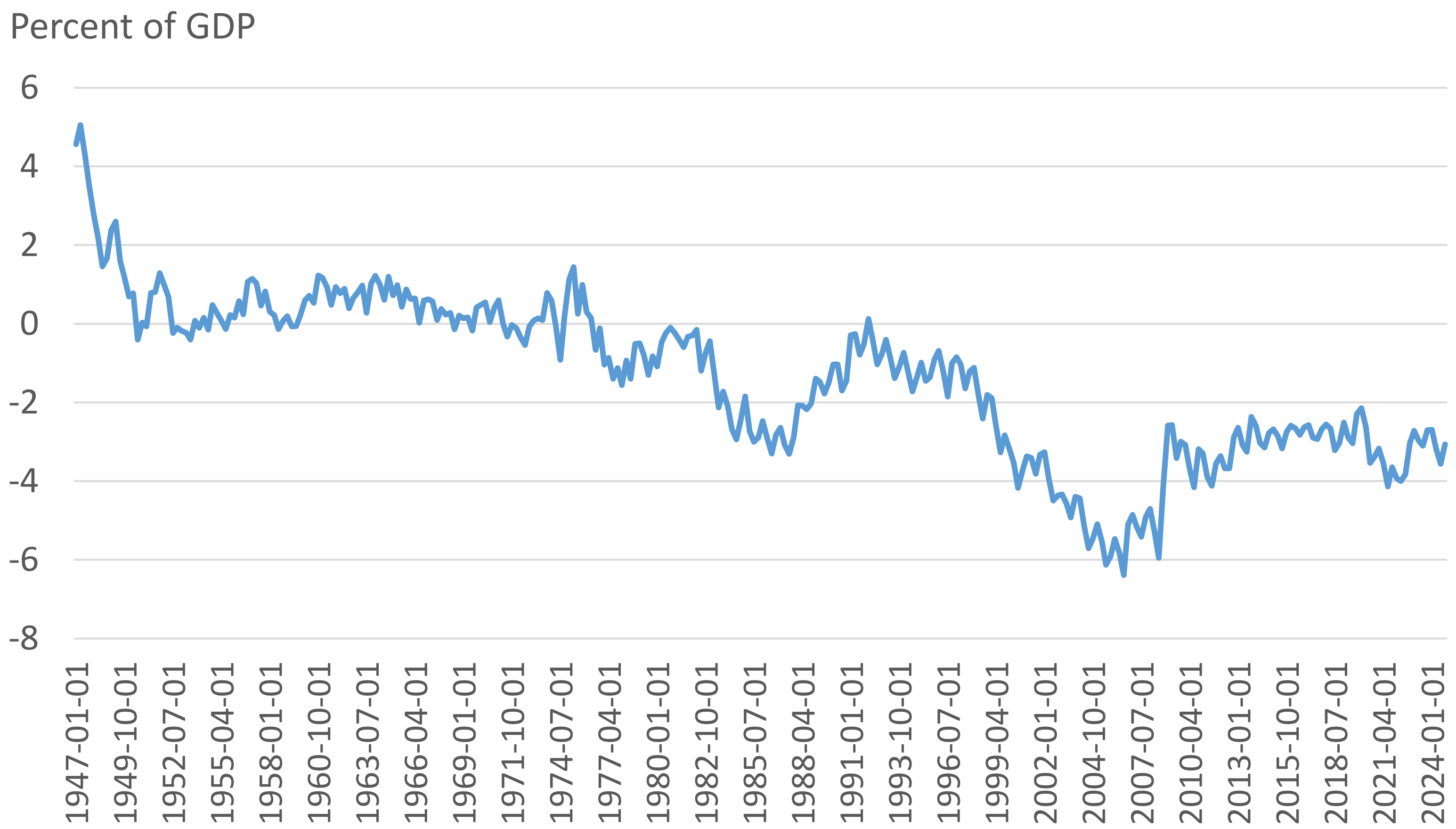
The US trade deficit is persistent and big



U.S. net exports of goods and services as a percent of GDP, 1947-2024.

Why do critics claim US deficits are harmful?

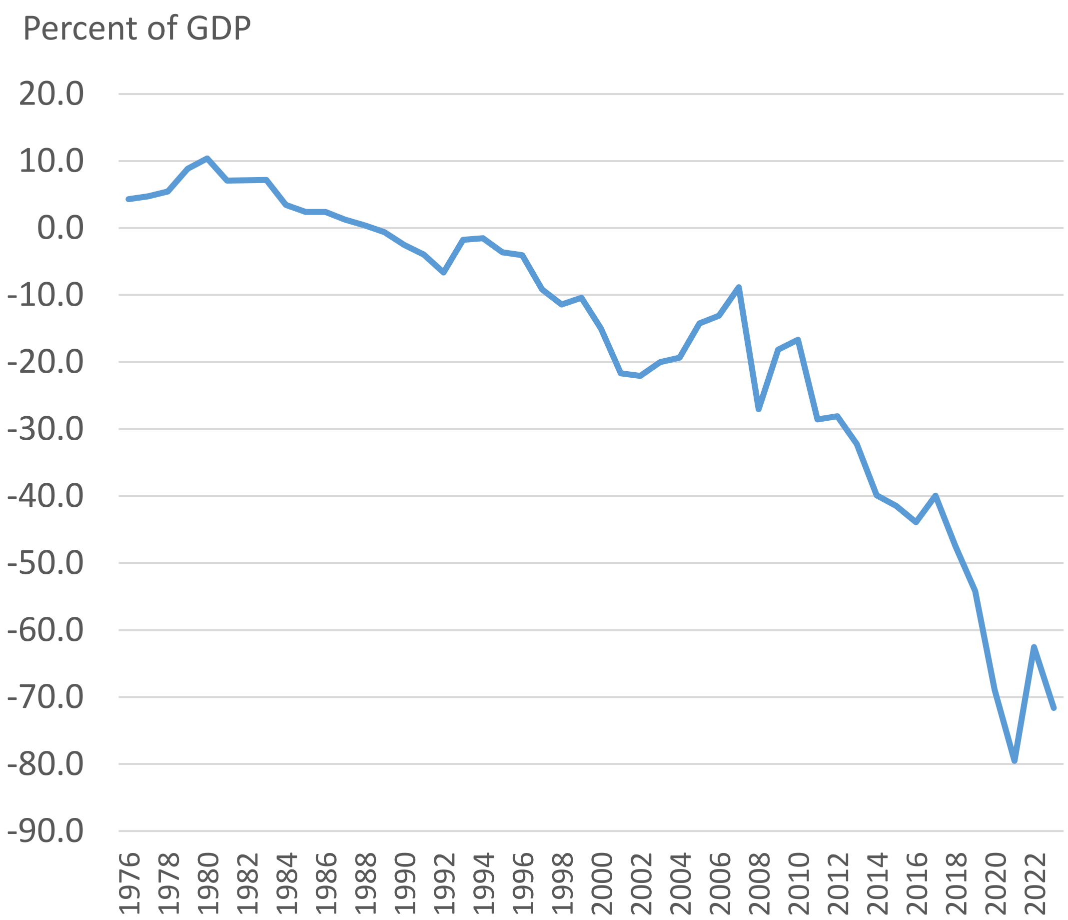


Exhibit A: US net international investment position

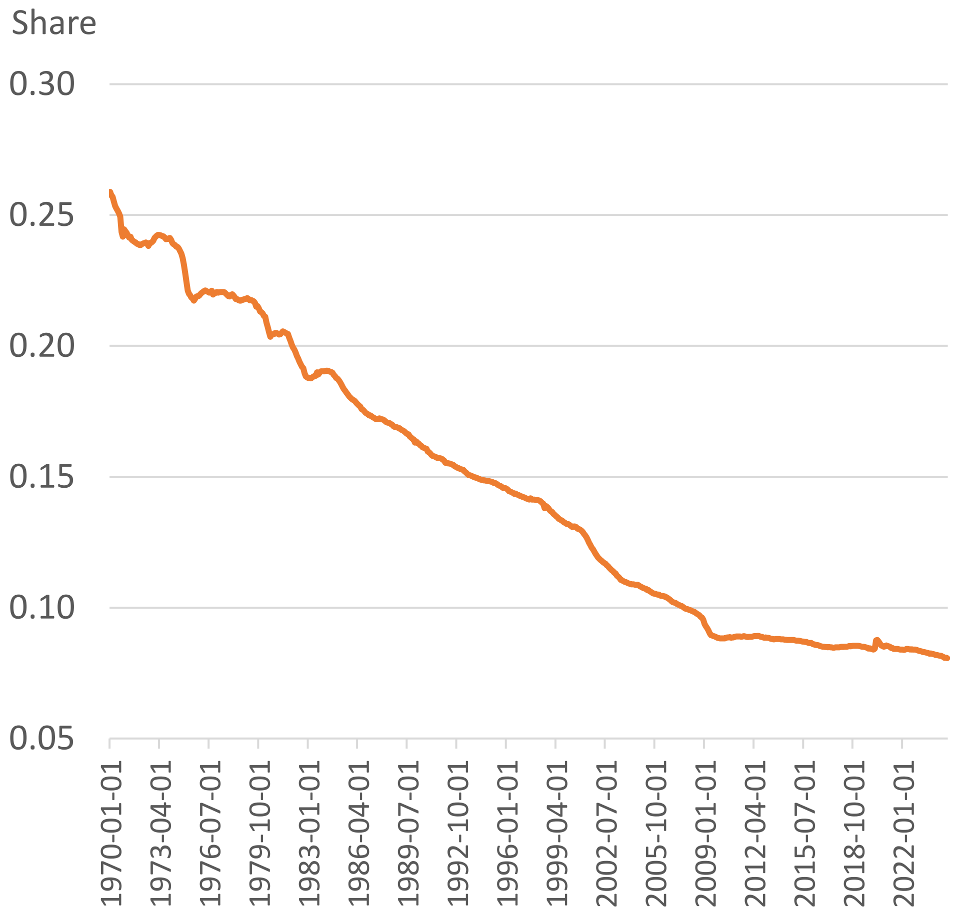


Exhibit B: Manufacturing share of nonfarm employment

Claims that US deficits are imposed from abroad drive narratives of US victimization

- Bernanke (Sandridge Lecture, 2005) locates “the principal causes of the U.S. current account deficit outside the country's borders”
- Dooley and Garber (*BPEA*, 2005): “The United States is passive and the foreign official sector is the active player in global imbalances”
- Klein and Pettis (*Trade Wars are Class Wars*, 2020): “The persistence of the American current account deficit can only be explained by excessive savings abroad and the US role in absorbing these excess savings”
- Lighthizer (*No Trade Is Free,* 2023): Trade liberalization and “unfair trade”

Different diagnoses lead to different policies

- If foreigners harmfully impose deficits on the US, then:
  - Tariffs?
  - Pressure on the Fed to depreciate the dollar – or a Mar-a-Lago Acord?
  - Capital inflow tax?
  - Better financial regulation?
- But even deficits that originate abroad can benefit the US:
  - More financing for investment?
  - Improved intertemporal terms of trade?
- And deficits that originate with US shocks can be good or bad
  - Consumption smoothing?
  - Productive investment finance?
  - Inadequate saving?
- Every transaction has two sides → identification problem: which curve shifted, and where?

Three myths

- US deficits are due to trade policies, its own and those of trading partners like China – tariffs and pressure tactics can rectify this

- The dollar's reserve currency role requires it to run current account deficits to satisfy growing world demand for FX reserves

- US deficits originate primarily in a global saving glut

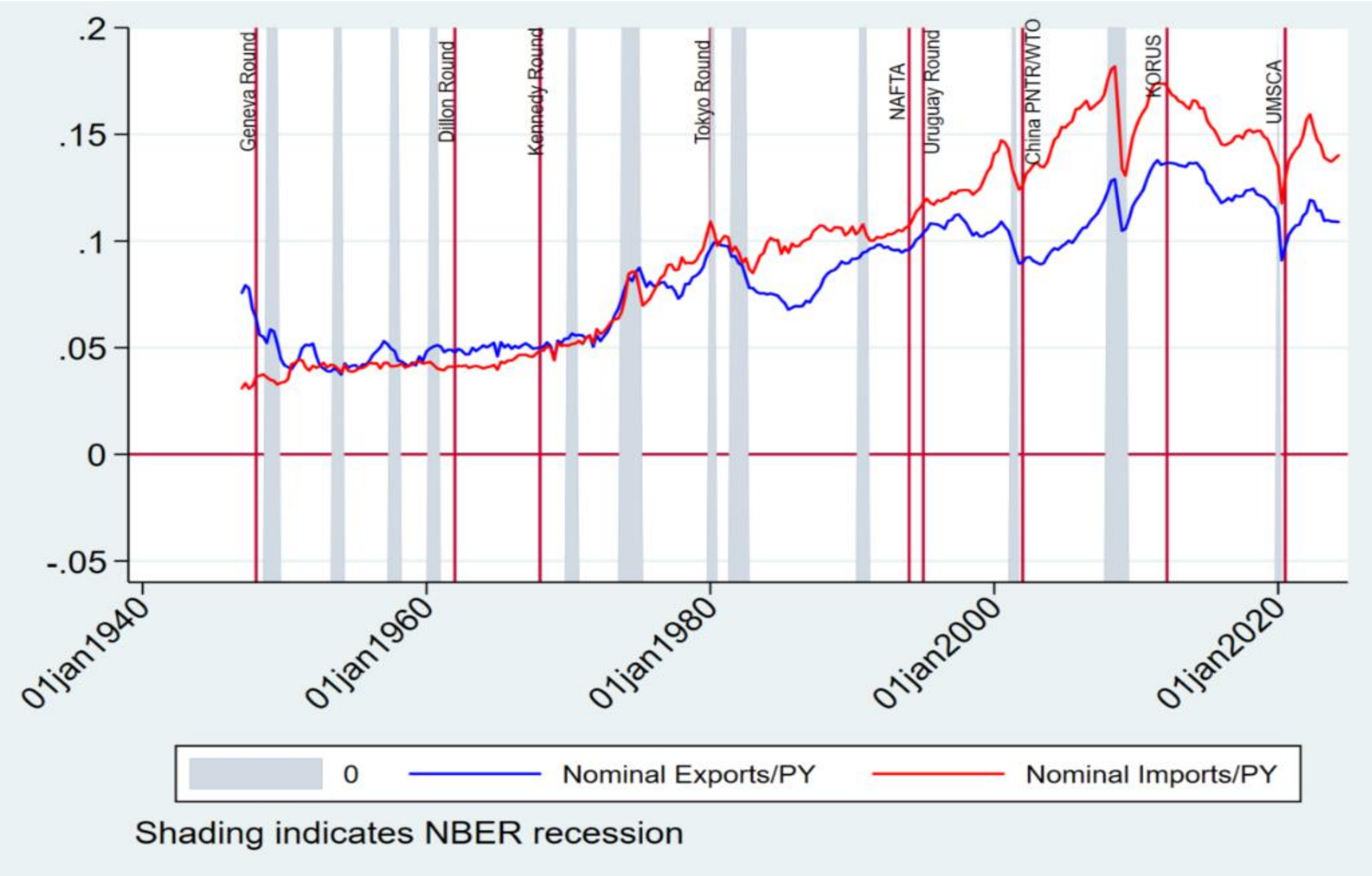
Three realities

- Some trade policies can matter, but likely are not the main cause of US trade and current account deficits, which will not necessarily be improved by broad-based import tariffs

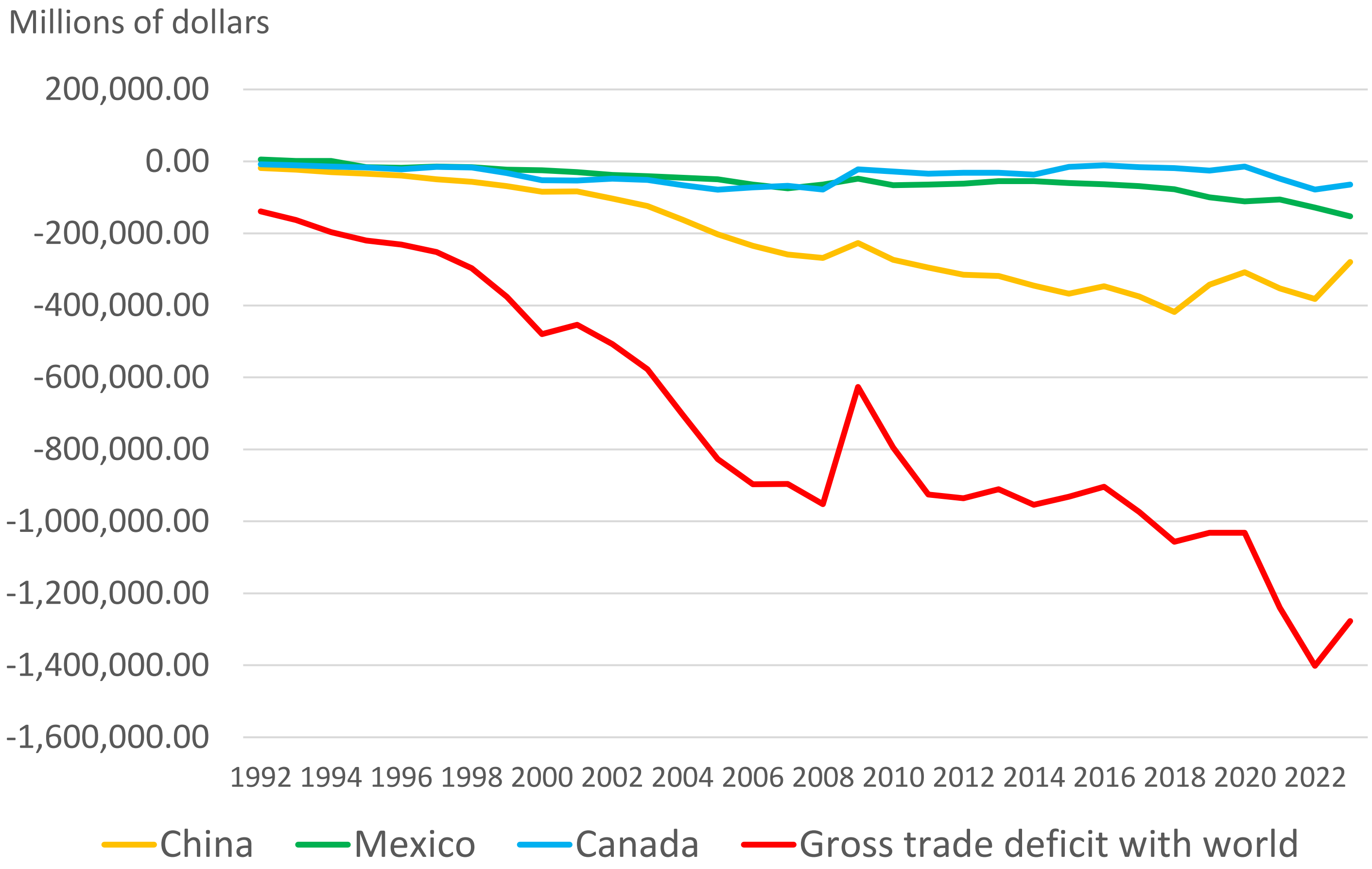
- The US reserve currency role possibly can lead to lower US exports compared with imports, but does not mandate US deficits: the US supply of dollar reserves to the world does not depend on the current account balance

- Both the global supply of external funds and the US demand for external funds matter, with different factors dominating in different periods; global portfolio preference (e.g., safe asset demand) also matters

Trade policy shocks: Circumstantial evidence

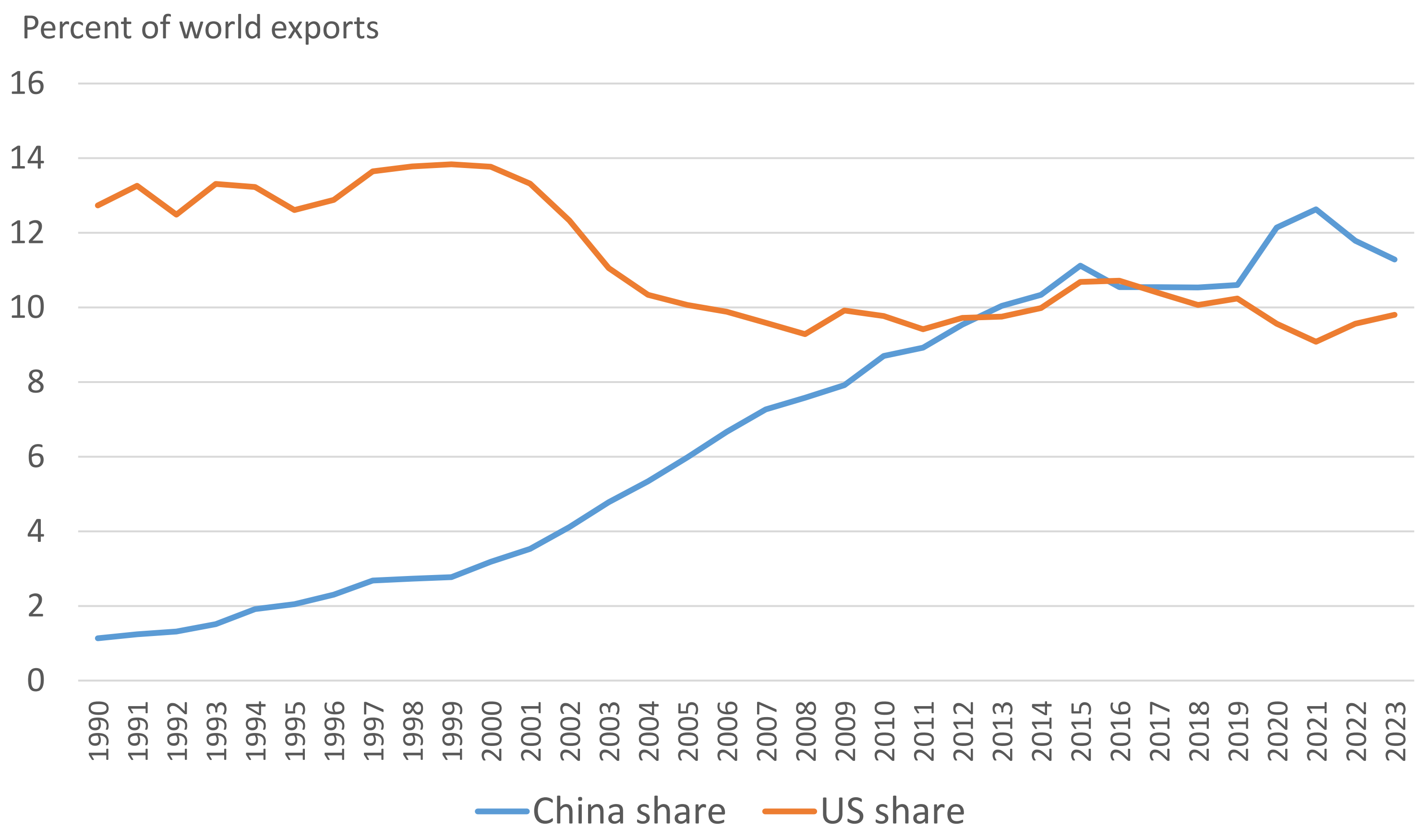


Not so fast: Consider NAFTA and China PNTR



U.S. trade balances in goods with China, Mexico, and Canada, and sum of bilateral deficits over all trade partners with which the United States is in deficit

Intense export competition from China after WTO entry – a negative macro shock for US



The Triffin problem, as retold by Miran

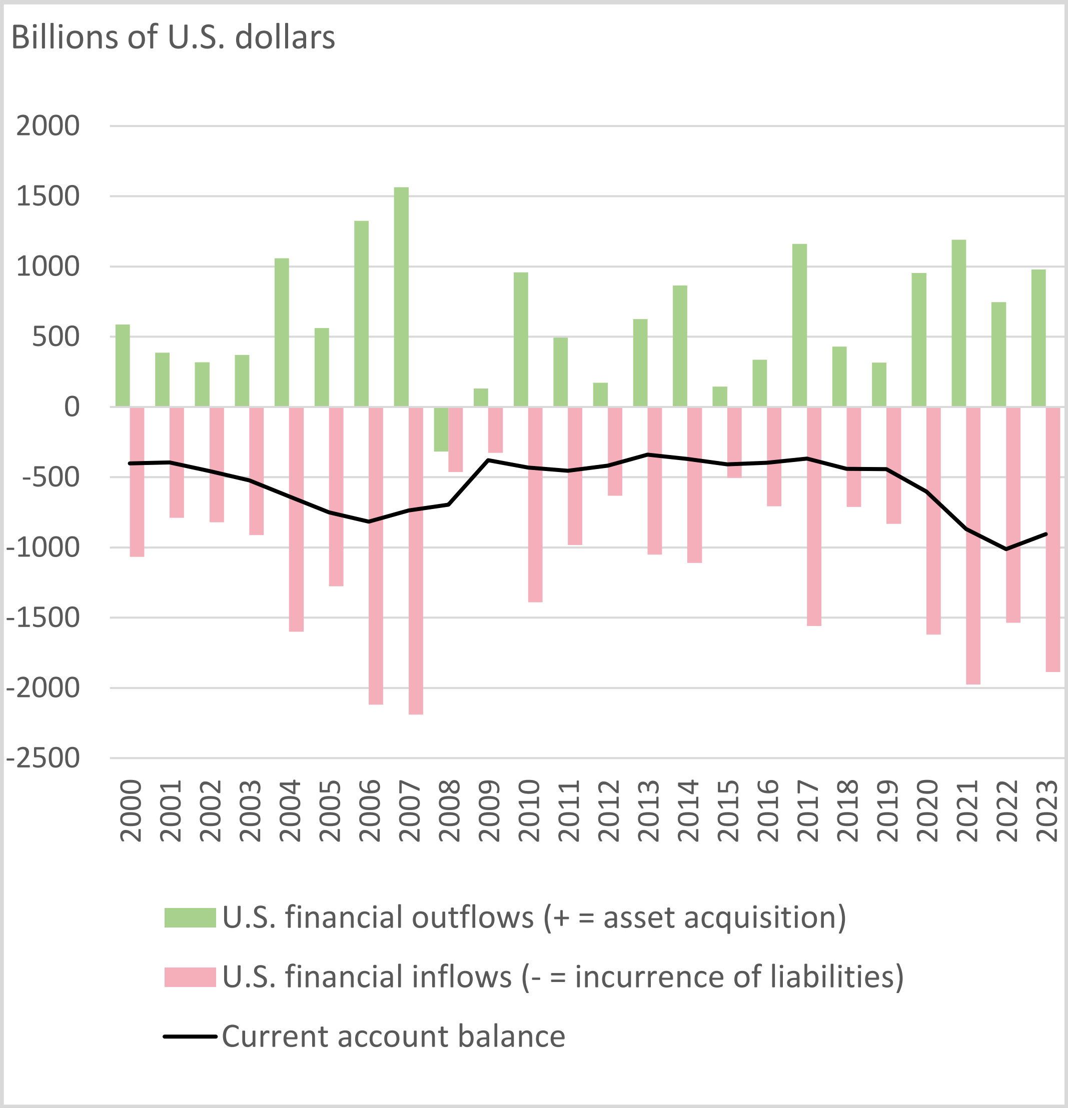
- Conceptual problem: Many international reserves are held outside US borders – origin of the Eurodollar market

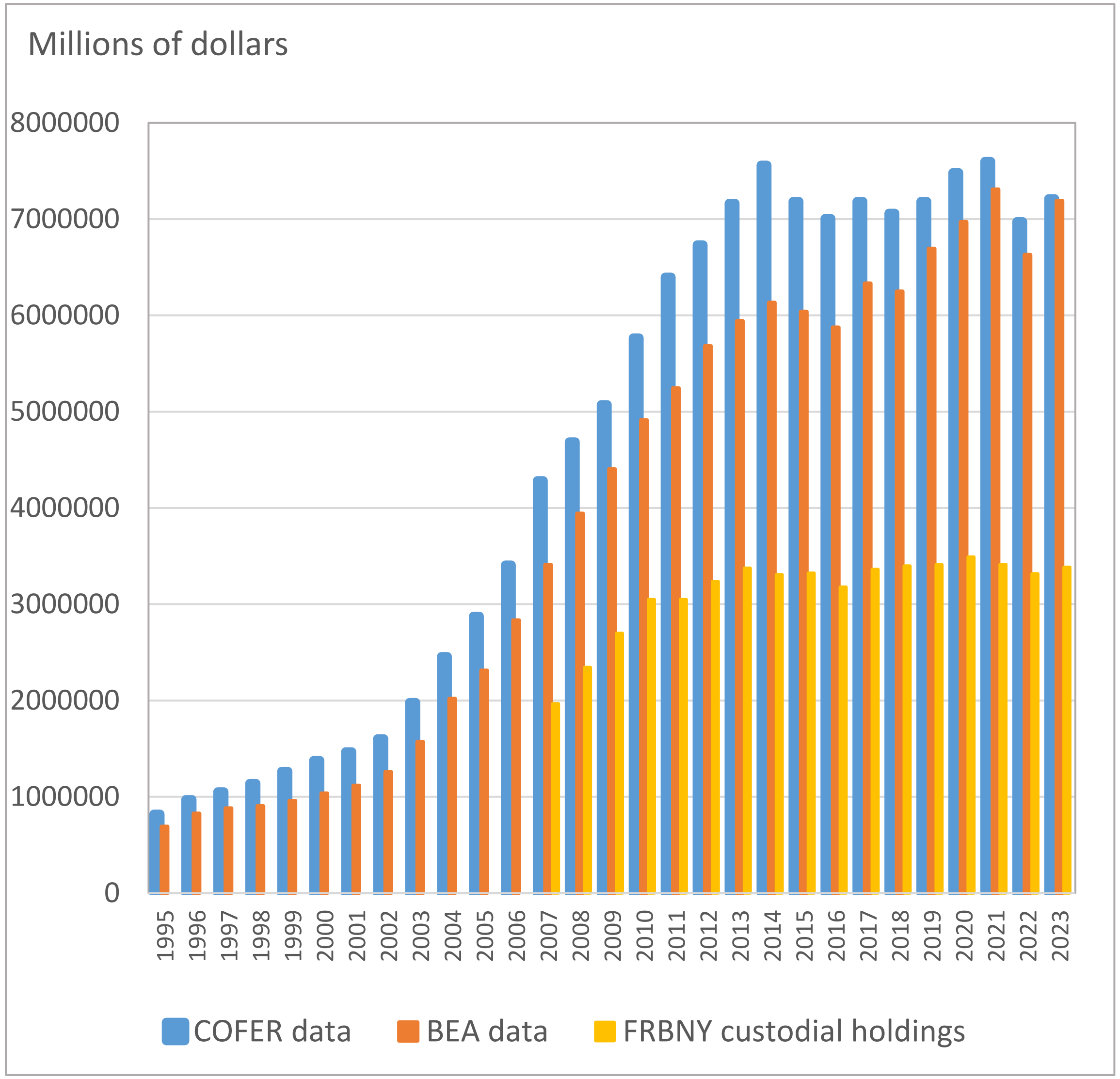
- Conceptual problem: Foreign countries can trade assets for US Treasuries, not just their exports

- Historical problem: This is not what worried Triffin

- Empirical problem: Global demand for dollar reserves has fallen as share of US GDP

Global dollar reserves and America's CA deficit

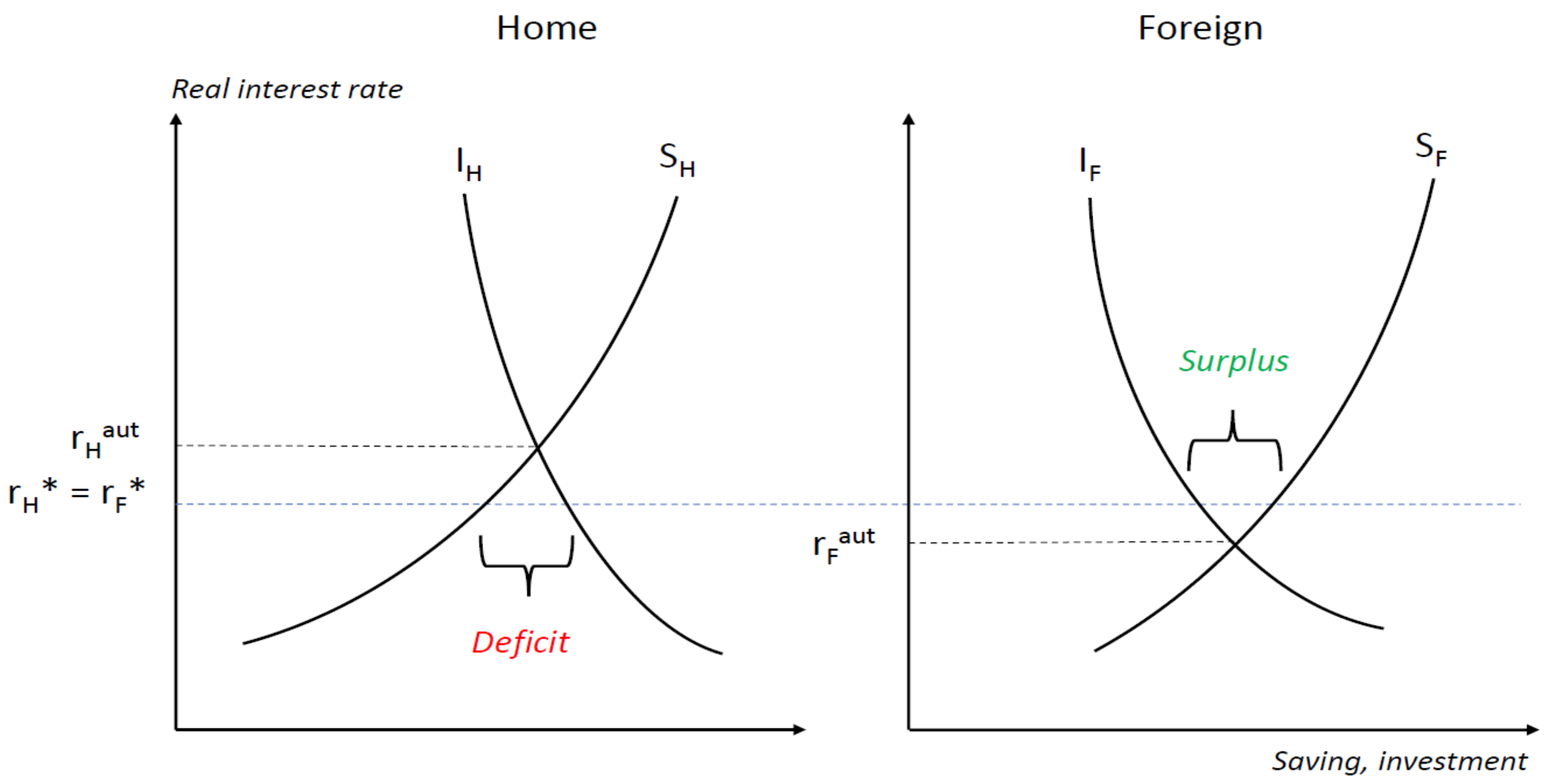




Caveats

- Global demand for dollars can affect the US currency’s nominal exchange rate (with fiscal policy offsetting deflationary pressures)
- Currency manipulation by a large country or many smaller ones (or both) can impact the US current account
- JD Vance: “[T]he reserve currency status is a massive subsidy to American consumers, but a massive tax on American producers”
- How big are these effects right now?

Home *and* foreign shocks can drive global imbalances



Example: Why revisit the 2000s deficits?

- Narratives about the deficits of the 2000s – which accompanied the China shock (Autor et al. 2013) and rapid US manufacturing employment decline – drive proposals from the current White House, drove Biden administration trade policies, and motivate other suggestions

- The imbalances preceded the Global Financial Crisis, and are sometimes blamed for it

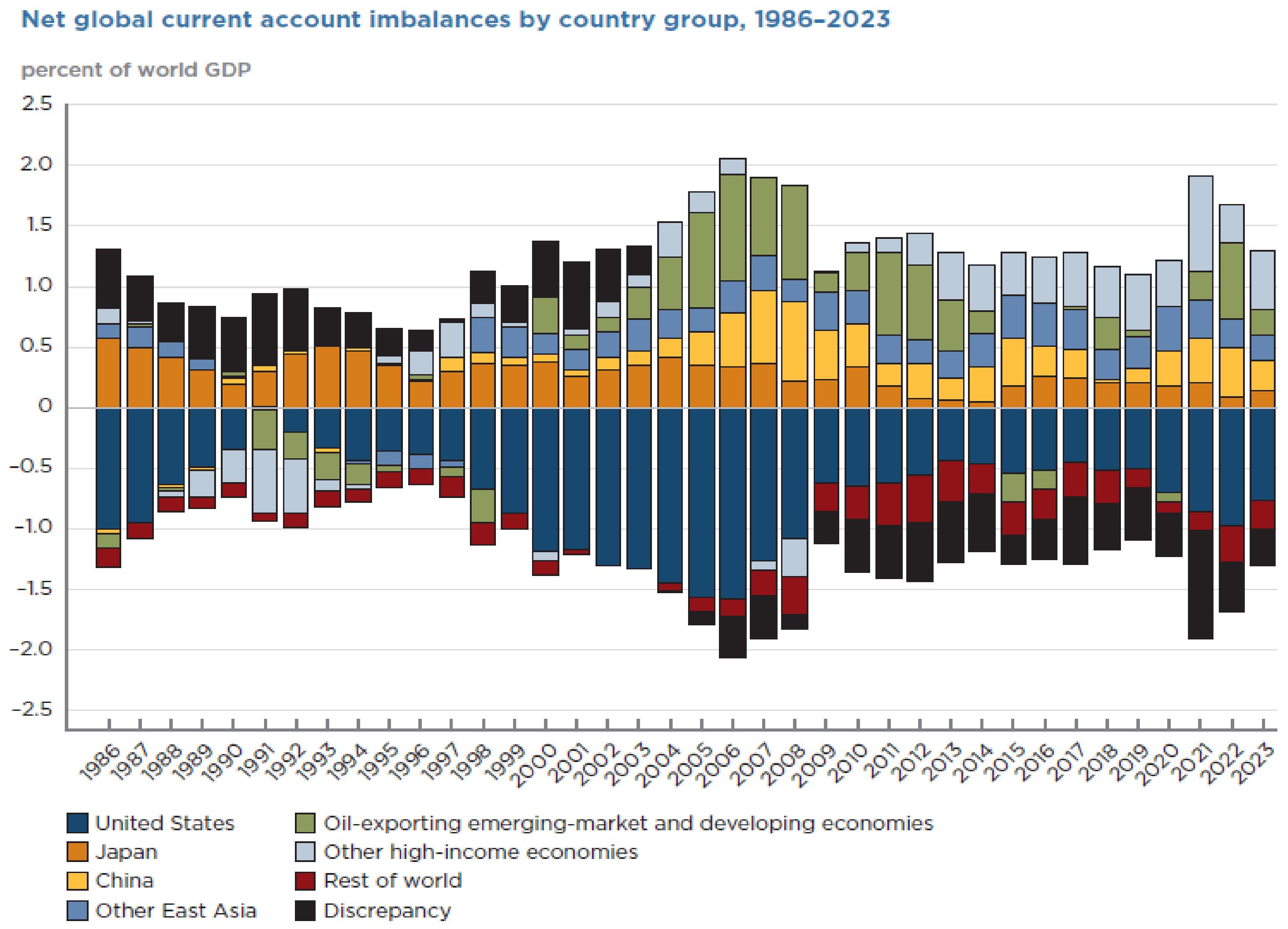
- These events had massive political implications that haunt us today – not just in America, but globally

A recent reassertion of the saving glut story

"The US trade deficit did rise from 1998 to 2008, before dropping back to 1999 levels in the early 2010s. The cause was not the [World Trade Organization], but the 1997 Asian financial crisis, after which Asian central banks substantially increased their holdings of foreign reserves, primarily by purchasing US Treasury bills. That resulted in the United States having a bigger capital account surplus, meaning that more capital was flowing into the United States than was flowing out. The United States offset that account surplus by importing more than it exported. The US trade balance was affected because US Treasury bills remained the foreign asset of choice for central banks around the world, which pushed up the value of the dollar, making imports cheaper and US exports more expensive, causing a large trade deficit."

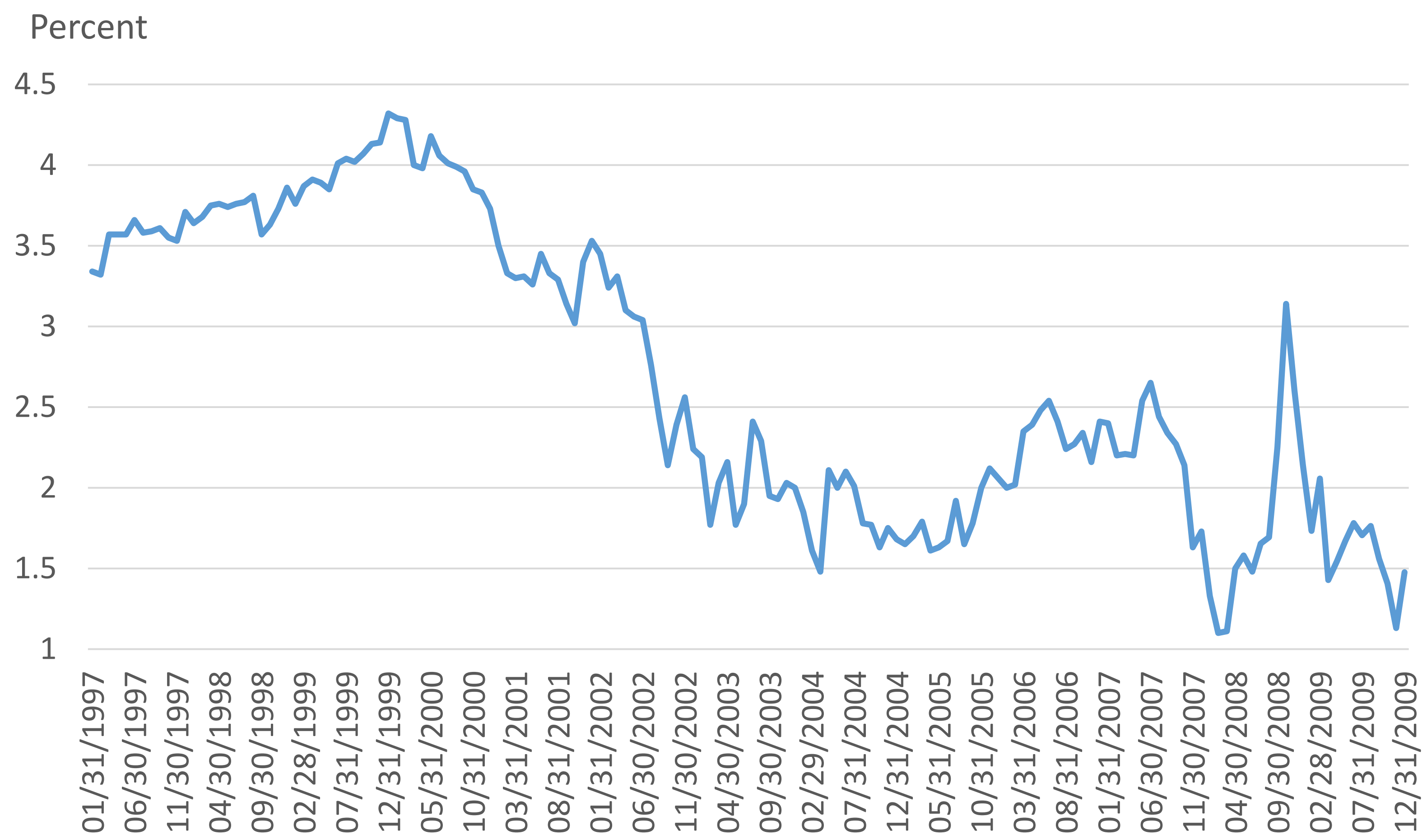
-- Gordon Hanson's review of Lighthizer (2023), in *Foreign Affairs*, January/February 2024

Global current accounts widened in the 2000s



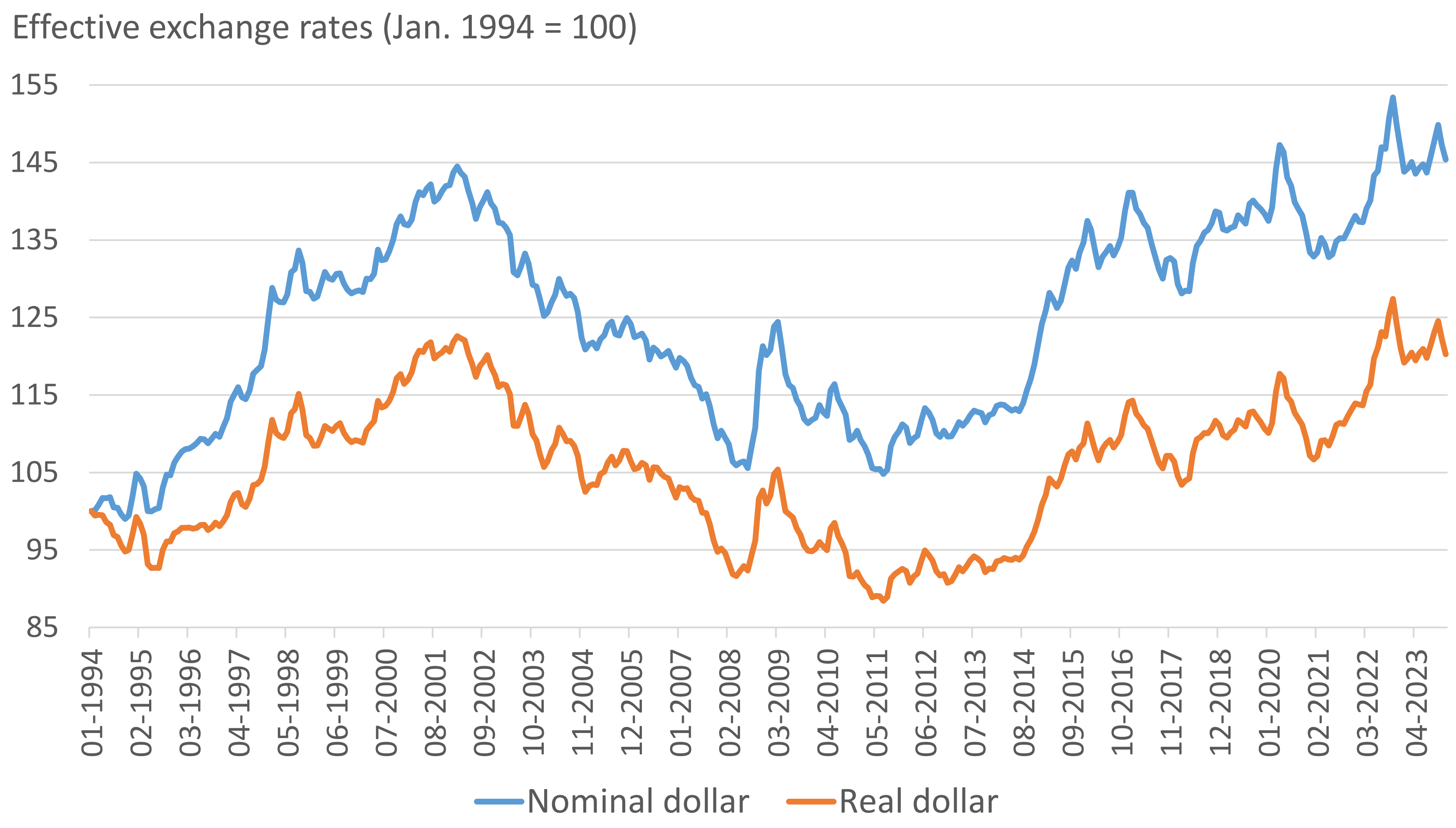
Sources: IMF, World Economic Outlook database, April 2024, with China data before 1997 from World Bank, World Development Indicators.

US ten-year TIPS yields



Source: Bloomberg

Having risen, USD slid from 2002:Q2 to GFC



Source: FRED

Alternative (more complex) narrative

- Data from 1998-2002 are most consistent with GSG narrative
- Data gaps and inconsistencies prevent full confirmation
- Starting in 2002, capital seems more **pulled in than pushed in**
- Hence, the dollar's depreciation
- Much foreign capital pulled in by high US consumption and debt issuance
- Strong residential investment (but not other investment)
- Fueled by low US dollar interest rates and loose financial conditions
- Notably innovations in housing finance – which also fueled *gross* capital inflows (Bernanke et al., IFDP, 2011; Bertaut et al., *JIE*, 2012; Shin, *IMFER*, 2012)
- Consistent with Obstfeld and Rogoff (SF Fed 2009 AEPC proceedings)
- Role of WTO in depreciating dollar cannot be dismissed – but a different channel from the China shock import surge, and US exports nonetheless grew

Conclusion

- US political discourse on trade deficits features “blame the foreigner” narratives of victimhood – heavily influenced by the 2000s
- Some recommend protective tariffs; others capital inflow taxes; others a weakened dollar, perhaps through a new international accord
- There is a (not groundless) fear that Chinese surpluses (and US deficits) will be associated with a “China shock 2.0” driven by China’s repressed consumption, overcapacity, and industrial policies
- But US macro conditions play leading role in determining US trade deficits *and the level of manufacturing employment*
- *Relatively favorable US stock market performance* has recently lowered the NIIP; but it has raised overall US wealth
- Trade policy can counter trade abuses, which do exist
- Macro problems require macro correctives, e.g., US fiscal correction

Thank you.