The Big Read **US trade**

Donald Trump's war on trade deficit backfires

The US president has made correcting the imbalance a focus of his administration. But the deficit has risen during his administration and he is partly to blame

OCTOBER 1, 2017 by Shawn Donnan in Washington

When Donald Trump launched a national security investigation into steel imports, Dan Simmons was one of those cheering.

Mr Simmons, the president of US Steelworkers Local 1899, has for years watched the union's members endure tough times as much of US Steel's Granite City facility in Illinois sits idle.

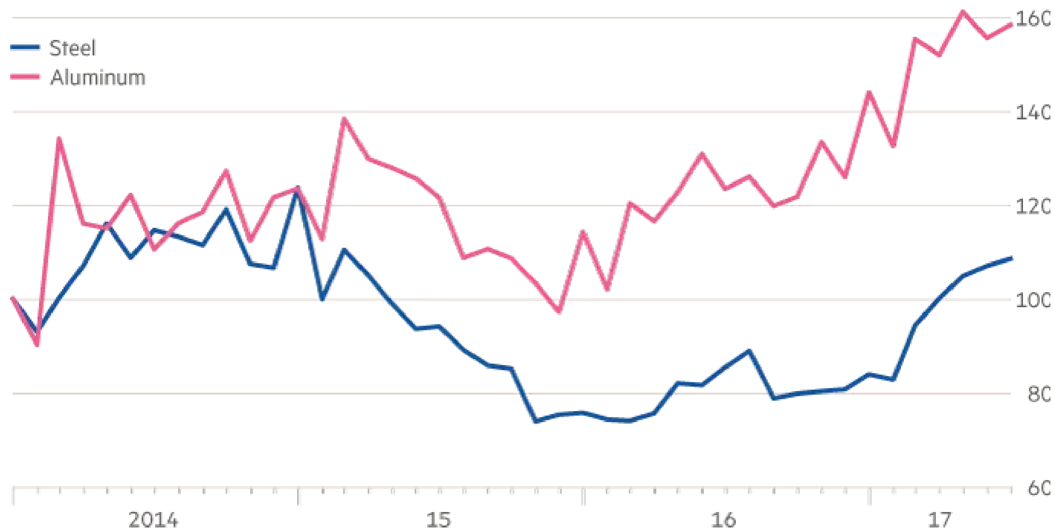
But after the Trump administration dug deep into the trade statutes and in April launched a "Section 232" investigation, which could lead to the boldest act of protectionism in support of the US steel industry in 15 years, he saw reason for hope.

Within weeks US Steel was promising to fire up Granite City's two blast furnaces across the Mississippi river from Saint Louis and rehire hundreds of workers. It was all part of a Trump-fuelled wave of optimism sweeping through an industry that had spent years lobbying for tougher measures to combat Chinese dumping of cheap steel that has left many US mills unable to compete.

Yet five months later, Mr Simmons is among those scratching their heads about the US president's policy. Instead of acting quickly as promised to levy tariffs on steel imports, the administration's plans have become bogged down amid internal battles and opposition from the broader business community and Republicans in Congress.

US steel and aluminium imports

Value terms (rebased)



Source: Panjiva

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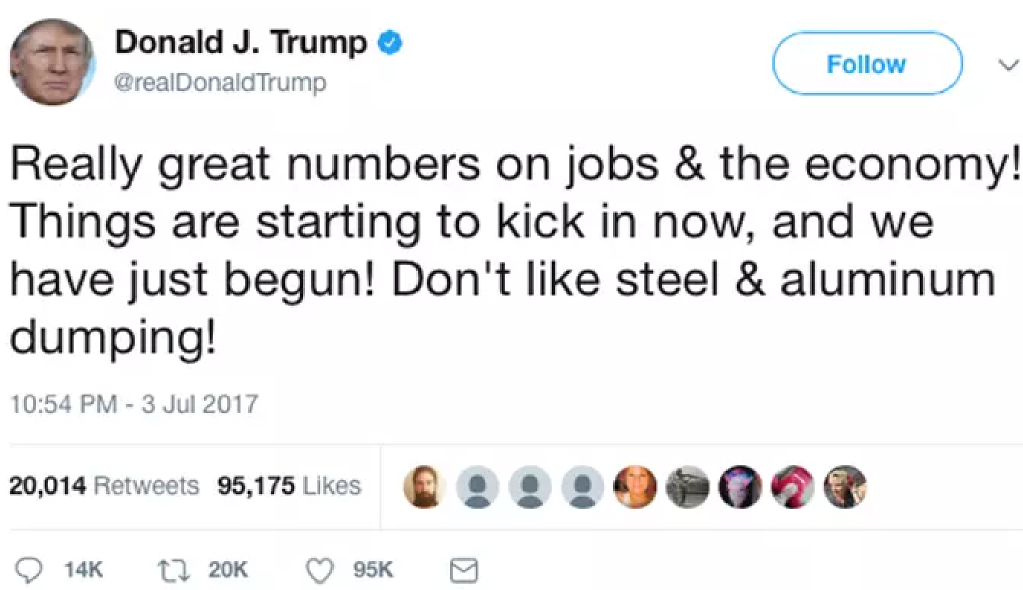
Even worse, Mr Trump’s announcement prompted a spike in imports as foreign suppliers and domestic consumers sought to get ahead of any higher tariffs and higher prices.

“It has actually had a negative impact,” Mr Simmons complained to the Financial Times as he was preparing to fly home last month after a lightning round of lobbying in Washington. “A little less talk and a lot more action is what we need.”



Mr Trump likes to crow about how many jobs the US economy has created since he took office and about how US equity markets have soared to records. But for someone who has turned the balance of trade into the ultimate metric of a country's performance — much to the chagrin of economists — he has been reluctant to mention another fact about his presidency.

When the latest US trade data figures are published on Thursday, they are likely to confirm a striking trend: in the first seven months of this year the goods and services trade deficit with the world rose to $320bn, up almost 10 per cent, or $27.9bn, on the same period in 2016. And it is not hard to make a case that Mr Trump is at least partly to blame.

Steel and aluminium are the most vivid examples. Since Mr Trump announced parallel national security investigations into imports of the two metals in April and proclaimed there were tough measures to come, imports of both have surged.

Steel producers in China and elsewhere have been increasing imports to the US amid talk of future tariffs © EPA

According to data collected by analytical group Panjiva for January to July, US imports of steel are up by $7.3bn, or 24 per cent, while aluminium imports were $2.8bn higher, a rise of 28 per cent compared with the same period in 2016. In the three months after the investigations were announced the US imported almost $4bn more steel than it did in the same months of 2016.

The two industries attribute much of the increase to both Mr Trump's campaign threats to get tough on imports and the stalled investigations, which the administration has parked for now in order not to anger Republicans as it seeks to press ahead with tax reform.

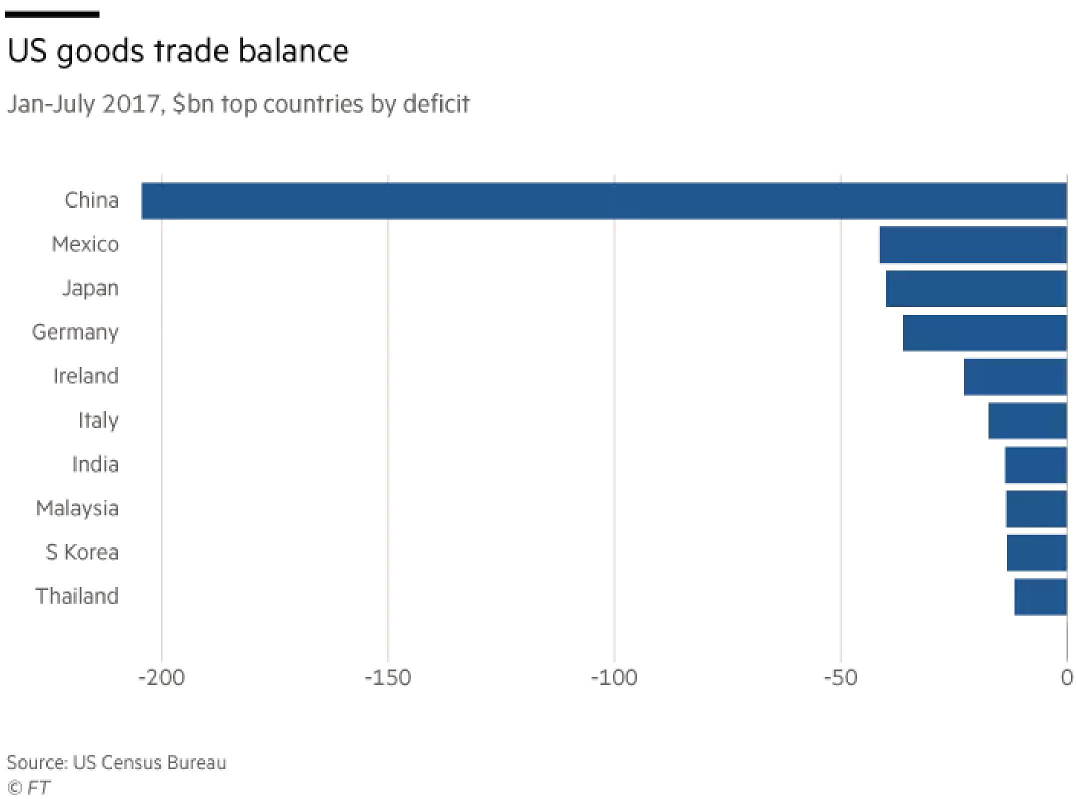
In a letter in September to Wilbur Ross, commerce secretary, urging him to speed up the investigations, Ohio senators Sherrod Brown, a Democrat, and Rob Portman, a Republican who served as US trade representative in the administration of George W Bush, complained that "the delay in the Section 232 investigation into steel imports" was causing a "corresponding surge of steel imports entering the US market".

Between May and June, the senators complained, imports of reinforced bar steel had spiked 84 per cent while the influx of tubular steel used by the oil industry had more than tripled in the first six months of the year.

"These import levels are unsustainable for US companies and their workers," they wrote. "Unfortunately, the steel sector expects them to continue to increase unless a conclusion of the Section 232 investigation is reached immediately."

Administration officials concede privately that the Section 232 investigations into aluminium and steel have caused a surge in imports and contributed to an increase in the trade deficit, though they blame the broader expansion of the deficit on higher commodity prices and an improving US economy.

But it is not hard to find other signs of a possible Trump effect on the trade deficit.



The dollar rose sharply immediately after Mr Trump's election in November. But thanks in part to growing scepticism about Mr Trump's ability to deliver his broader economic agenda, the dollar is down 9 per cent in trade-weighted terms since it peaked in late December 2016.

While ultimately that should be good for US exporters and the balance of trade, in the short term it has contributed to a higher cost of imports, particularly of commodities priced in dollars such as oil, one of the main contributors to the widening goods deficit this year.

“An administration’s tough rhetoric on trade can be thwarted by other policies that affect the trade balance in sometimes paradoxical ways in the short run,” says Eswar Prasad, a former senior International Monetary Fund economist who now teaches at Cornell University.

Like most other economists, Mr Prasad argues that the trade deficit the US has run since the 1970s — and the broader current account deficit — is largely meaningless and has more to do with the country’s macroeconomic strength, its low savings rate and the dollar’s status as the world’s reserve currency than trade patterns.

While some left-leaning economists blame the trade deficit for the US’s loss of manufacturing jobs, most others point to the march of automation and business trends such as the outsourcing of services for the bulk of the impact.

But Mr Trump’s zero-sum view of the world — in which surplus economies are carnivorous winners and deficit economies their prey — remains the guiding economic principle of his administration. And that makes the trade deficit one of his ultimate metrics for success.

“The president believes — and I agree — that trade deficits matter,” Robert Lighthizer, Mr Trump’s US trade representative, told a Washington audience recently. “I think it is reasonable to ask, when faced with decades of large deficits globally and with most countries in the world, whether the rules of trade are causing part of the problem.”

For the administration, the core belief is that the trade deficit has caused widespread manufacturing job losses in the US and stagnant wages, which would be reversed by closing the deficit.

The administration has set reducing the $64bn annual goods trade deficit with Mexico in particular as the main goal of the renegotiation of the North American Free Trade Agreement now under way. Mr Lighthizer, similarly, is pointing to a persistent bilateral trade deficit with South Korea as he seeks to renegotiate an agreement with Seoul that took effect in 2012.

$27.9bn

Year-on-year rise in the US goods and services trade deficit in the first seven months of 2017

24%

Rise in imports of steel to the US in the first seven months of 2017, a $7.3bn increase year on year

9%

Fall in the dollar in trade-weighted terms since its peak in December 2016

The model Mr Lighthizer is pursuing is based in large part on one he employed while facing off with Japan as a young deputy US trade representative in the Reagan administration. One of the main tactics the US used then was to negotiate “voluntary export restraints” on products such as cars and semiconductors with Tokyo and other economies with which it had trade deficits.

Proponents including Mr Lighthizer argue that the strategy forced Japanese automakers and other companies to build factories in the US, thus creating American jobs.

But critics charge the strategy also had downsides, including helping to push Japanese carmakers into the luxury segment and raising the cost of goods such as semiconductors and televisions. When the administration of George HW Bush took office in 1989 one of its first moves was to unwind many of those restraint agreements.

Three decades on, the US still has a trade deficit with Japan, with the US importing $55bn more in goods and services than it exported in 2016. And for that reason the Japan example illustrates in part why most economists believe using the trade deficit — and particularly bilateral deficits — as a scorecard for an economy is a misplaced obsession.

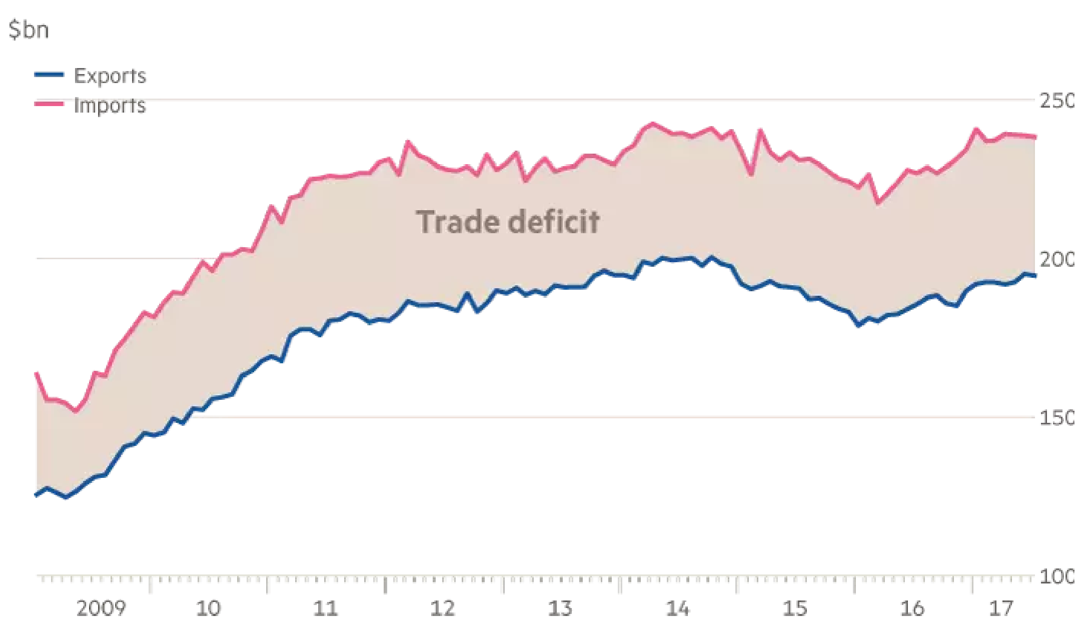
Anne Krueger, who served as the top US official at the IMF and as the World Bank's chief economist, argues that the dollar's status as the world's reserve currency bears more responsibility for the current account deficit than any trade agreement. Also to blame, she says, are the US's low savings rate and its persistent government budget deficits.

The situation is made more complicated by the globalisation of supply chains, which has helped drive down the cost of complicated manufactured goods such as cars. More than half of US imports are either parts or raw materials, making them crucial to exports.

That means cracking down on imports — such as those of steel or auto parts — can hurt US manufacturers and exporters further up the value chain.

"If we cut off our deficit with Mexico by cutting off imports of auto parts, then we're going to be cutting off our own exports," Ms Krueger says.

US exports and imports of goods and services



Sources: Thomson Reuters Datastream, US Census Bureau

If the trade deficit is the Trump administration's primary concern, the better option, she argues, would be for Mr Trump and his administration to do the opposite of what they are planning to do and focus on incentives for consumers to save or to improve the US fiscal position — either by raising taxes, cutting spending or a combination of the two. Instead, the administration last week unveiled a plan for tax cuts that most economists expect to weaken the US fiscal position.

The frustrating reality for economists like Ms Krueger has long been that the politics of trade usually run counter to what they see as the obvious economic truths.

But Mr Trump may be confronting a new lesson on the link between politics and economics. Nine months into his presidency his attempts to rewrite the rules of global commerce have done more to increase the US trade deficit than to cut it. And for that there may well be a political price.

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Like many of the workers at the Keewatin Taconite mine in Minnesota, which produces iron ore pellets used to make steel, Dan Pierce spent a year struggling to make ends meet after being laid off amid an industry downturn in 2015.

A procession of anti-dumping cases restricting imports from places such as China and South Korea have helped improve life for the steel industry and the mine — owned by US Steel — is back up and running at full capacity.

But the mechanic, who also serves as vice-president of the local steelworkers' union, is watching the influx of imports racing to get ahead of any tariffs and the administration's hesitation with trepidation.

"It can go the other way real quick," Mr Pierce says. "And every day that passes without some recommendation from the president . . . it puts the steel industry in danger. Basically they are putting the steel industry right back into the same shape it was in 2015. And that's not in good shape."

Nafta: The car industry, an emblem of lost value

Donald Trump often appears to view trade deficits much like a chief executive zeroing in on an underperforming division. And right now no US subsidiary is more in the presidential spotlight than the North American Free Trade Agreement with Canada and Mexico.

The president has made clear that the primary goal in the renegotiation of Nafta launched in August is reducing the $64bn trade deficit with Mexico.

To deliver on that, the administration is focused on the trade in cars and encouraging at least a partial repatriation of auto supply chains that stretch from Detroit to Mexico and Canada and back again. It argues that along with a growing deficit with Mexico, the 23-year-old Nafta has brought a reduction in the US content contained in Nafta-built cars and other manufactured goods.

In a study released last month, the US International Trade Administration cited OECD data showing that the US value-added portion of manufactured products imported from Mexico had fallen from 26 per cent to 16 per cent between 1995 and 2011.

That study ignored other OECD data showing that, as a result of the expansion in trade between the US and Mexico, the absolute value of the US component of imports from Mexico have more than tripled since 1995 to almost $40bn by 2014.

But that is a moot point for an administration that has set reducing the trade deficit with Mexico as a metric for success. It wants to increase the Nafta regional content requirements for cars and introduce a rule that more of the production is carried out in the US.

Whether that will either fly with Canada or Mexico or work to reduce the trade deficit are open questions. But they illustrate how Mr Trump has shifted the debate.