America's trade deficit begins at home

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Thanks to fear mongering on the US presidential campaign trail, the trade debate and its impact on American workers is being distorted at both ends of the political spectrum. From China-bashing on the right to the backlash against the Trans-Pacific Partnership (TPP) on the left, politicians of both parties have mischaracterized foreign trade as America's greatest economic threat.

In 2015, the United States had trade deficits with 101 countries – a multilateral trade deficit in the jargon of economics. But this cannot be pinned on one or two "bad actors," as politicians invariably put it. Yes, China – everyone's favorite scapegoat – accounts for the biggest portion of this imbalance. But the combined deficits of the other 100 countries are even larger.

What the candidates won't tell the American people is that the trade deficit and the pressures it places on hard-pressed middle-class workers stem from problems made at home. In fact, the real reason the US has such a massive multilateral trade deficit is that Americans don't save.

Total US saving – the sum total of the saving of families, businesses, and the government sector – amounted to just 2.6% of national income in the fourth quarter of 2015. That is a 0.6-percentage-point drop from a year earlier and less than half the 6.3% average that prevailed during the final three decades of the twentieth century.

Any basic economics course stresses the ironclad accounting identity that saving must equal investment at each and every point in time. Without saving, investing in the future is all but impossible.

And yet that's the position in which the US currently finds itself. Indeed, the saving numbers cited above are "net" of depreciation – meaning that they measure the saving available to fund new capacity rather than the replacement of worn-out facilities. Unfortunately, that is precisely what America is lacking.

So why is this relevant for the trade debate? In order to keep growing, the US must import surplus saving from abroad. As the world's greatest economic power and issuer of what is essentially the global reserve currency, America has had no trouble – at least not yet – attracting the foreign capital it needs to compensate for a shortfall of domestic saving.

But there is a critical twist: To import foreign saving, the US must run a massive international balance-of-payments deficit. The mirror image of America's saving shortfall is its current-account deficit, which has averaged 2.6% of GDP since 1980.

It is this chronic current-account gap that drives the multilateral trade deficit with 101 countries. To borrow from abroad, America must give its trading partners something in return for their capital: US demand for products made overseas.

Therein lies the catch to the politicization of America's trade problems. Closing down trade with China, as Donald Trump would effectively do with his proposed 45% tariff on Chinese products sold in the US, would backfire. Without fixing the saving problem, the Chinese share of America's multilateral trade imbalance would simply be redistributed to other countries – most likely to higher-cost producers.

I have estimated that Chinese labor compensation rates remain far less than half of those prevailing in America's other top-ten foreign suppliers. If those countries were to fill the void left by a penalty on China, like the one that Trump has proposed, higher-cost producers would undoubtedly charge more than China for products sold in the US. The resulting increase in import prices would be an effective tax hike on the American middle class. That underscores the futility of attempting to find a bilateral solution for a multilateral problem.

The same perverse outcome could be expected from the reckless fiscal policies proposed by other politicians. Take, for example, the ten-year $14.5 trillion federal government spending binge proposed by Democratic presidential candidate Bernie Sanders – a program judged to be without any semblance of fiscal integrity by leading economic advisers within the very party whose nomination he seeks.

Government budget deficits have long accounted for the largest share of America's seemingly chronic saving shortfall. The added deficits of Sandersnomics, or for that matter those of any other politician, would further depress America's national saving – thereby exacerbating the multilateral trade imbalance that puts such acute pressure on middle-class families.

Seen through the same lens, mega trade deals, such as the TPP, would also have an important bearing on pressures that squeeze American workers. The TPP would effectively divert trade flows from those countries that are not a part of the agreement to those that are. With China excluded from the TPP, the same phenomenon noted above would result: American middle-class families would be taxed by the diversion of trade away from low-cost non-TPP producers such as China toward higher-cost TPP signatories such as Japan, Canada, and Australia.

In short, trade bashing is a foil for the vacuous promises that politicians of both parties have long made to American voters. Saving is the seed corn of economic growth – the means to boost American competitiveness by investing in people, infrastructure, technology, and new manufacturing capacity. The US government, through decades of deficit spending and advocacy of policies that encourage households to consume rather than save, has forced America to rely on foreign saving for far too long. This has undermined US competitiveness, punishing workers with the job losses and wage compression that trade deficits invariably spawn.

America's 101 trade deficits don't exist in a vacuum. They are a symptom of a deeper problem: a US economy that has lived beyond its means for decades. Saving is but a means to an end – in this case the sustenance of a thriving and secure middle class. Without saving, the American Dream is in danger of becoming a nightmare. The trade debate of the current presidential campaign heightens that risk.

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