The Daily Dish

Unpleasant Trade Arithmetic

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Eakinomics: Unpleasant Trade Arithmetic

Let's review some macroeconomic accounting (because that's what everyone wants to do on a Monday morning!). Imagine that the country of Eakinomony uses all its workers, factories and technologies to produce $1 trillion worth of goods and services. Its citizens purchase $800 billion in household purchases while its firms undertake $400 billion in new investment in structures, equipment, and technologies. To cover the gap of $200 billion between its income ($1 trillion) and total outlays ($1.2 trillion), Eakinomony borrows $200 billion abroad. Conveniently, foreigners have $200 billion in dollars because they sold that amount of goods, services, and investment goods to Eakinomonians. In the dull arithmetic of introductory international economics, total output ($1 trillion) is equal to the sum of household consumption ($800 billion), investment ($400 billion) and net exports (-$200 billion). Simultaneously, net capital inflows ($200 billion) match the external deficit ($200 billion).

Suppose now that Eakinomony reaches an agreement that requires Trumpland to buy an additional $200 billion of its exports. Given its income ($1 trillion), interest rates, and so forth, there is no particular reason for households or firms to change their plans to purchase $1.2 trillion of domestic production. So what will happen to the additional $200 billion from the exports? Citizens and firms will use it to import another $200 billion in goods from around the world because net exports (-$200 billion) have to match the mismatch between domestic income and spending. There will be more exports, but also more imports that leave the net unchanged.

This short parable is relevant to the Trump Administration's declaration that the trade war with China is on hold. The two sides agreed to not impose tariffs while they begin to implement the agreement reached last week. A key part is China purchasing $200 billion in additional exports over the next three to five years. This is good news. It means that the potential for a trade war has been pushed back. It means that there may be progress in protecting U.S. intellectual property (the jury is still out). But it does not mean that the U.S. trade deficit will move one iota, a good reason that the Chinese would not agree to a specific reduction in the bilateral trade deficit. The question is whether the administration will stick to this agreement when it become obvious that it can do nothing to alter the U.S. export balance.