Trade Balances, Tariffs and Trade Wars

There are differing opinions being tossed about these days, either that we are returning to fiscal prosperity or we are running headlong into a repeat of the 1930's. The stock market is at an exuberant high, and those that judge the economy by Wall Street's performance point to it as an indicator of economic growth. Those who look at today's Wall Street, where stock prices far exceed a company's profits, dividends and book value, look at the market as a speculative bubble ripe for busting. Some prefer to point to high employment figures and feel all is right with the world. Others look at the high deficit and predict inevitable doom and gloom.

There are those that say the Great Depression of the 1930's was caused by government interference in the form of big Federal programs that deepened and lengthened an economic contraction, which in turn led to reduced manufacturing and high unemployment, and then to reduced international trade. Others say the high Smoot-Hawley Tariffs led to a trade war, which caused a drop in international trade, which then caused reduced manufacturing and resultant high unemployment - and eventually the Great Depression,.

One thing is for sure, economists are more like Medical Examiners than Internists, better at speculating on a cause of death than diagnosing an illness and dispensing a sound regimen for a return to health.

Most macro economists are involved in the study of a government's relationship with private investment capital, banking, high finance, and large manufacturing.

Economists all hang out different shingles in selling their wares. In one form or another they are either Keynesian big government advocates or Friedmanesque free market Supply Siders. Most who are associated with government policy making are to a great degree Federal Reserve oriented investment analysts - looking at tweaking government's involvement in the economy to produce business profits and economic growth. The goal for these economists is a hallowed 3% yearly GDP rise and returns on investment between 5% and 7%.

All their calculating, of course, is centered mostly on big business. Any benefits the average working stiff might receive from an economic bounty is really only a byproduct of Federal policy affecting corporate profits and anticipated increased Federal revenues. These economic gains, when actually achieved, are passed through to citizens (and non-citizens as well, as of this writing) in the form of government handouts or trickle down private sector employment benefits and lower taxes. Jeffersonian economics that demands a small government, balanced budgets and rejects Central banks is a thing of the past. While corporate executives receive tremendous remuneration and large investors look for returns North of 5% - it is rare for the average salaried worker to receive raises anywhere near that number. Still, any raise in income is better than income stagnation - or so the mantra goes.

The most recent talk from the White House is about the Trade deficit and the implementation of Tariffs to correct it. The opposition's response has been dire warnings about a trade war. There's little mention of the thousands of tariffs that are already on the books. And, there's absolutely no mention of the fact that tariffs in of themselves are not villainous. It is tariffs as an additional tax to an already onerous Internal Revenue income tax, high excise taxes and a system of gargantuan penalties for all types of mis-steps with Federal regulations that is villainous.

Some economists have found little correlation between negative economic growth and the size of the debt. These economists are not looking at the cost of the debt to the individual citizen as a tax, and the money it siphons out of the economy - but that is really another story, albeit an important one to many who see bloated government as dangerous to Liberty.

The same goes for a trade deficit. There are different reasons for a trade deficit, some good, some bad. A trade deficit is not necessarily bad. Though, what causes it may be. As with the national debt, there is little correlation between negative economic growth and a trade deficit or a correlation between positive economic growth and a trade surplus.

From a different perspective, if one looks at trade as the purchasing of goods from a supplier outside American borders, merely buying more than you sell presents no problem if you have the money to buy. If an individual decides to spend all his money on purchases that total less or equal to what capital he has available, there's no great harm done to him. He may not have money left in the bank after the purchases, but if he has sufficient future income to support his future needs, then it's really no concern to him if he spends all of his money now. Of course, if he is trying to build a large cash fortune, then his expenditures are an impediment to his goals.

Governments don't work like that. It is not their goal to build capital or have cash on hand for future expenditures, although at one time governments depended on commodities like gold and silver, even jewels, to establish their worth. That no longer appears to be the present situation.

Therefore, the analogy of a country’s trade deficit to an individual's spending is not quite apples to apples, as countries are not like people. Countries generate all of their money by collecting taxes. Countries don't deal with money in the way that individuals or businesses do. The government is not buying and selling for profit. Therein lies the difference. The question then is why is a trade imbalance a concern for the government? It's not their money that's being spent. The money belongs to individuals and businesses. So, why is Donald Trump so concerned about trade imbalances? Again, it's not the government's money. Why then is trade any concern of the government at all in a free market economy?

At the beginning of the country there was little manufacturing. We were mostly an agrarian society, buying most of the manufactured goods we needed from mother England. But, there was nascent manufacturing, especially after the Revolution, spurred on by the self sufficiency demanded during the War. The Constitution equalized internal trade by removing interstate tariffs, and established an uniform trade policy with foreign nations to make it more amenable for foreign business to deal with all of the states equally when exporting to the United States. From the very beginning, certain domestic manufacturing sectors were protected by higher tariffs imposed on the importation of products similar to the products produced by these manufacturers. It was a protectionist tariff. The most despised of all tariffs, and yet that is what Mr. Trump has up his sleeves. Regardless of how Trump describes his tariff, once there are exceptions and unequal standards applied to particular products from particular countries, it is a targeted punitive tariff.

It is quite possible to design a fair trade policy utilizing tariffs as income generators and a reducer of internal individual taxes, but that concept is nowhere to be found among the Washington hack politicians.

In the 1790's the new central government felt that it was in the nation's best interests to nurture manufacturing in the young nation. While tariffs were applied equally to all countries regardless of their export policies to the U.S., certain foreign manufacturing sectors were penalized with an extra 2%. Whether it was the dissuasiveness of the extra percentage points on certain imported goods that allowed young American industries to grow or other factors - the tariffs were there and the county's manufacturing grew.

In the 1970's, almost two hundred years later, something odd happened. The central government decided to destroy American manufacturing and help certain fat cats get rich by investing in China and importing goods that were much cheaper than what could be made in a country like the U.S. with one of the highest standards of living in the world. This was done by signing a special trade deal with China. China helped out by suppressing Chinese workers' salaries, keeping working conditions below standard and offering special incentives to Chinese exporters. Adding to the lower production costs, the Chinese manipulated their currency so that even costlier Chinese goods were relatively cheaper for export.

Some investors were in on the killing from the beginning. Many American companies became American in name only, and while they reaped certain benefits by maintaining the facade of being American, they were foreign companies with stateside offices. This differed greatly from the past when production was in America and distributed internationally. In those days American companies were American, although they had offices and distribution centers world-wide. These multi-lateral corporations had large Stateside manufacturing as their base, although they obtained their resources worldwide and had manufacturing and representation in many countries for foreign distribution.

Companies like ESSO (Exxon) drilled in foreign countries, had foreign refineries and even had distribution in the form of gasoline stations station worldwide. Shell and BP, two foreign owned companies had widespread distribution in the US. A company like Colgate Palmolive was so well integrated into certain foreign countries, such as Italy for example, that Italians thought that Colgate (pronounced / k oʊ l g ɑ: t ə) was an Italian company. International trade was very much alive, but so was American manufacturing.

Soon after the opening of China and cheap manufacturing, American retail companies were formed with the goal of cashing in on the selling of cheap Chinese made products in America. The effect was stunning. Even with the cost of shipping to the U.S., an American could buy a Chinese product for much less than a similar product made in the USA, still leaving substantial profits for the manufacturer and distributor, which in many instances were the same. Soon this happened in Europe as well.

The problem with Americans buying cheaper Chinese goods was that each Chinese purchase was a stab in the heart of American production. American manufacturing was subject to pensions, health benefits, higher wages, stringent environmental regulations, stronger safety regulations, etc. And, the American government wasn't incentivizing exports to China with the same special deals the Chinese government was giving to its exporters. To add insult to injury, China imposed high tariffs and restrictions on American made goods vying for the Chinese domestic market. The US government did nothing.

As American factories closed because of its inability to compete against unfair state supported foreign competition, defunct companies' assets were purchased for pennies on the dollar, many of the employees' pension funds were raided and the manufacturing equipment was ripped out and shipped to China. Soon more trade deals like the China deal were cut with other nations and groups of nations. NAFTA was one of them.

Small independent retail stores were left with only a few of the American products they had sold for years; and even if they wanted to compete, they couldn't afford to buy in the same volume as the syndicated big box China marts. As people lost their manufacturing jobs they got lower paying jobs at a host of Big Box China marts like Waly World, Home Depot, Circuit City and Best Buy. Even if Americans wanted to support their local stores, the only products American workers could now afford were cheap Chinese goods. As the small stores all across America collapsed, one by one the downtowns in which they were located collapsed as well. The only game in town was cheap goods from China, Malaysia, Vietnam, Burma, and Mexico among a list of impoverished factory countries.

The China trade imbalance is one of those situations where a trade deficit is a negative for the U.S.. The purchase of Chinese goods would not in of itself be a bad thing if the Chinese competed on a level playing field. But, the competition is grossly unfair. We are far from a free market economy where competition, cut throat or otherwise, is governed solely by the private marketplace. Our nation has a managed economy, a state capitalist economy. Taxes, trade deals, varying product and sector tariffs, corporate and business tax regulations that favor or hinder certain businesses, environmental and safety regulations that have varying impacts on business operations, we give incentivizing tax credits for taking out a mortgage, for putting money in the bank, for having children, for buying new equipment, for tilling the soil, for not tilling the soil, federal loans for all kinds of investments, taxes that treat different kinds of income differently - and a multitude of programs and laws that sink their teeth into and their tentacles around businesses of all kinds.

While we hear complaints about foreign government assistance and special policy and programs for exporters, the U.S. also aids certain industries. There are oil depletion allowances, farm subsidies, tax breaks for companies that do certain things that the government feels is beneficial to this group or that group or to the profitability of entire industries or sectors of the economy.

There is much talk about tariffs to force foreign nations to obey the rules. Some on the Right, especially Neo-Cons, free-marketeers and supply-siders dislike tariffs. Some even despise them, in spite of the fact that they are as American as apple pie. History disputes a rigid economic positioning against tariffs. Tariffs are described as anti-free market, anti-capitalism and anti-American. They are, in fact, very American. Of course, you can have too much of a good thing. And, you can have too many things all at once. That is the problem, at least much of the problem - too many taxes, especially the income tax. For those who cherish liberty, and some few still do, direct taxes are anathema.

In the beginning, U.S. tariffs served two functions. Mostly tariffs served to fund the government. That was good. Tariffs are a tax. And, those who describe and decry them thusly, are correct. In 1791 there was no direct capitation tax. Putting aside a short lived un-Constitutional income tax during the Civil War, until the passage of the 16th amendment, the US Government was funded with excises and tariffs - both of which took from your pocket, but left your liberty and privacy alone.

Alexander Hamilton, as Secretary of the Treasury, created two levels of tariffs in 1791. There was the across the board 3% money collecting tariff and there was the added 2% punitive protectionist tariff, intended to promote the growth of certain American industries. The extra percentage points were to act as a stimulus to buy American - how gauche of them!

Of course with the advent of intrusionary taxes, the tariff was looked at as a trade control measure, which it is.

Tariffs can be applied across the board or the can be targeted - either to an industry or product or to a nation. So, when President Trump declares that a tariff on products will be applied to a product that immediately signals a protectionist tariff. But, then when he declares that there will be exemptions for sundry reasons, ranging from national defense, to favored nations, and so on, that signals cronyism and special deals. In this instance, the free-marketeers are to some degree correct - it is big government picking winners and losers by penalizing certain sectors and protecting others, albeit done in the name of correcting a defined trade injustice. The imposition of the tariffs is being done in the name of Fair Trade and a Balance of Trade Deficit.

The oft maligned Balance of Trade Deficit, as mentioned, is very subjective as an economic determinant, and has no inherent meaning for predicting an economy's health. It is merely a measure of how much has been imported in comparison to what has been exported. Trade exists when you want something you don't have and someone else has it . If you have the money to buy it, you make a deal. That's commerce. If two people have something you want, and one of them is selling it at a much lower price, and you buy the one at the lower price, that's also fine. The exception would be if the cheap seller has made some nefarious harmful arrangement that has allowed the lower price, then that's bad. On a much simpler level, take the example of buying a TV off the back of a truck. The price may be cheaper, but the price saving may lead to some factory or store going out of business, and ultimately costing some people their jobs as the businesses for which they work go under because of repeated inventory loss.

Trade imbalances that are the result of legislated policy built on corrupt arrangements are truly bad. They are intended to make certain people extremely wealthy, with no regard for the harm it does to the United States. It is often accompanied with benefits being received by corrupt foreign leaders, officials, their families and friends. American and international interests that have opened shop in the foreign countries and are benefiting from special trade deals either offer out a quid pro quo up front or are just as often subject to shakedowns in one form or another which accompanies the privilege of operating in the foreign country.

While couched in different terms, from a business perspective, it is not much different from municipal and state officials using public money or special tax breaks or dedicated construction projects to get large chain retailers, manufacturers and sports franchises to establish their operation in a particular location in the United States. The difference being that this form of corruption is accepted as being beneficial to the citizens of a particular American geographical entity. Of course, while there may be some future tax benefits, employment and prestige associated with landing a certain entity in a community, the prime beneficiaries are never the average citizen.

Investment is costly and risky. Therefore investment must be rewarded or there would be no investment. For the sake of a healthy marketplace, some few favored investments cannot be allowed to receive special benefits from government. When that happens competition becomes impossible and eventually all investment will cease, except for those favored few. The greatness of America was the willingness of investors to try their luck in the marketplace. When investors understand that the game is rigged, then they stay away.

Competition is good for business, but unfair advantages do not benefit everybody. True free trade demands a level playing field, otherwise investment capital will be drawn to areas where manufacturing is cheaper and will negatively impact those who play fairly.

The challenge facing us as importers is how quickly we can implement a Comparative Production Cost Equalizing Tariff that is a neutral reflection of the exporting nation's manufacturing and financial practices in several categories.

Below are a few suggested, but not a comprehensive list of categories:

A) Manipulation of their currency to artificially reduce the cost of manufactured items intended for export.
B) Government subsidies for products intended for export,
C) The wage level of workers.
D) The amount of attention to environmental protection and pollution in manufacturing,
E) Working conditions.

F) The general level of health care and the type of health care system in a country.
G) Intentional government interference in trade unions.
H) A foreign country’s import controls and Tariffs on American made goods

If we can look at all exporting countries equally and apply the same standards to all countries, the onus of the size of the tariff placed upon their exported goods would be on them. The terms and conditions of the application of tariff ‘points’ would be known by all exporting nations. Germany, for example, which has a high standard of living, is environmentally responsible, has healthy working conditions and honorable monetary practices, might only have the minimum tariff applied to its products. On the other hand, China because of the way it deals with its workers, the environment, its export and import policies, might have a hypothetical 50% tariff applied to its exports. The solution to China's penalty would be up to China to solve by reevaluating its practices.

There would be no reason for trade retaliation by a country after a fair tariff system is put into place. The solution to any nation’s high tariffs when exporting to the U.S. would be in the hands of that nation.

If, in the long run, it is still cheaper to import products from a country with the maximum tariff applied to its imports, at least the money collected would supplement the American treasury and lessen the tax burden on U.S. Citizens. On the flip side of the equation, if after a fair tariff system is put in place, certain U.S. companies are still unable to compete, then the market would determine their fate.