THE WALL STREET JOURNAL.

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ECONOMY | THE OUTLOOK

Why Trump's Effort to Narrow the Trade Gap Has Flopped So Far

The president's tax policies are as much in play as tariffs

President Trump discussing trade practices with Reps. Sean Duffy (R., Wis.), left, and Robert Aderholt (R., Ala.), at the White House earlier this year. PHOTO: MANDEL NGAN/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Josh Zumbrun

March 2, 2019 5:25 p.m. ET

President Trump set his sights on reducing mammoth U.S. trade deficits. In the coming week, the Census Bureau will likely report the U.S. last year registered the largest trade deficit in its history.

How that happened is a lesson in the economics of imbalances. In this case, the president's tax policies were as much in play as his trade policies. Large fiscal deficits had the side effect of enabling businesses and consumers to purchase more goods from abroad, driving down overall U.S. saving and driving up the trade imbalance.

"The evolution of the trade balance over Trump's first two years is a good illustration of the basic principles that led most economists to predict the trade deficit would continue to widen with Trump's policies," said Brad Setser, a senior fellow at the Council on Foreign Relations.

It has been a year since Mr. Trump's trade agenda shifted into high gear. It was March 1, 2018, when the president announced he would move forward with global tariffs on steel and aluminum, and on March 22 he began the process of putting tariffs on an initial $50 billion of Chinese goods.

Throughout 2018, more and more of these tariffs went into effect, and by September, the tariffs had been imposed on around $300 billion of goods, or about 12% of all U.S. imports.

Tariffs were successful in one sense: they brought China to the table for detailed negotiations. Mexico and Canada agreed to rewrite the North American Free Trade Agreement, and South Korea agreed to revise its free-trade deal with the U.S. as well. Those negotiations were all accelerated, at least in part, by the imposition or threat of tariffs.

But tariff policies so far have fallen well short of the president's oft-stated goal of narrowing the trade deficit.

The Commerce Department's report on fourth-quarter gross domestic product, released Thursday, showed imports exceeded exports by a record $914 billion in 2018, up from $859 billion the year before, and topping the previous record of $905 billion from 2006. The deficit is now about 16% larger than when Mr. Trump took office.

For the year, the economy grew 2.9%. A trade deficit subtracts from the calculation of GDP growth. Last year, the growth in the trade deficit subtracted 0.2 percentage point from GDP. So by that metric, the trade deficit is what kept the economy from reaching Mr. Trump's other goal of 3% growth.

A separate Commerce Department report, focusing just on merchandise trade, showed the deficit in goods widening by 10% in December from a year earlier. The nation's main trade report from the Census Bureau, which will show the detailed breakdown of trade in goods and services for 2018, will be released Wednesday.

"The point is the overall trade deficit is not determined by commodity trade, it's determined by macro," said Sherman Robinson, a senior fellow at the Peterson Institute for International Economics.

Over the past year, macroeconomic factors have overwhelmed any attempts to target specific trade deficits. Most powerfully, the combination of tax cuts and increased federal spending provided immense fiscal stimulus.

The fiscal stimulus had two effects. First, it provided an abrupt jolt to U.S. consumption. Companies imported more to satisfy the demand. U.S. imports averaged 24% of total consumer spending between 2000 and 2016, meaning every $100 of new consumption translated to roughly $24 of imports. If U.S. factories and service providers can't ramp up production, even more of that money might flow abroad. In 2018, imports were nearly 27% of consumption.

Second, the fiscal boost to the U.S. economy happened when much of the rest of the world was slowing. That contributed to an environment in which the Fed was raising interest rates and the dollar was strengthening. When the dollar is strong, it's cheaper for Americans to import and more expensive for the rest of the world to buy U.S. exports, widening the trade gap.

The latest deal with China seeks to boost U.S. exports directly by getting the Chinese to agree to large purchases of American goods, like soybeans or energy. This strategy may not be particularly effective either, said Megan Greene, global chief economist of John Hancock Asset Management.

"Even if China agrees to buy more of our stuff, it doesn't seem like U.S. firms can produce that much extra stuff, it just means we'd have to divert it from somewhere else," she said. More soybeans purchased by China, could simply mean fewer purchased by Indonesia and Taiwan, for example, leaving the U.S. not much better off overall.

To Mr. Setser, large U.S. trade deficits are a problem worthy of tackling.

"I don't think it is healthy for the U.S. to persistently run large trade deficits. I think that does weaken the manufacturing side of the U.S. economy and weaken those parts of the country that are reliant on manufacturing," he said.

But tariffs lead countries to retaliate—almost all U.S. tariffs were met with corresponding tariffs from trading partners. The level of U.S. exports, which had been steadily climbing for two years, began to decline in May.

"I would be thrilled if the deficit came down because of strong growth in U.S. exports over this year," Mr. Setser said. "I just don't think it's terribly likely."

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