Righting Global Imbalances

The United States will have to do its best to keep its own trade deficit in check, while helping to rein in its partners’ surpluses.

By Bruce Stokes

The Obama administration’s principal trade challenge in 2010 is to get ahead of the issues instead of just reacting to them. In its first year in office, preoccupied by higher priorities and presiding over a Democratic congressional majority that is deeply divided on trade, the White House allowed events to define policy. The “Buy American” provisions in the economic stimulus package and the recently imposed tariffs on imports of Chinese tires, both of minor economic significance, engendered a firestorm of criticism about protectionism. To avoid another year of distracting, rearguard actions against such complaints, President Obama and his team need a strategic trade plan.

The cornerstone of this effort may have to be policies that ensure a sustainable reduction in the U.S. trade deficit and parallel declines in the trade surpluses of China, Germany, and Japan. The International Monetary Fund blames the recent catastrophic instability of the worldwide financial system on ever-widening global imbalances over the past few years. To prevent such deficits and surpluses from regenerating, the G-20 nations, meeting in Pittsburgh in late September, pledged to “adopt macroeconomic policies ... that promote adequate and balanced global demand.”

The U.S. current-account deficit, the broadest measure of America’s balance sheet with the world, was 5.3 percent of gross domestic product in 2007. By the end of 2009, it will have fallen to about 3 percent, according to estimates by William Cline, a senior fellow at the Peterson Institute for International Economics.

A recent study by Standard Chartered Bank, however, found that “much of this improvement is cyclical, explained by the U.S. recession and slump in world trade. Fewer imports are narrowing the large trade deficit, but as the recession ends, it is likely that the trade balance will deteriorate again.”

To head off another round of global financial instability, the Obama administration will need to pursue a weaker currency, and work for trade and industrial policies that encourage Americans to produce more of what they consume and prompt the Chinese, Germans, and Japanese to consume more of what they produce.

To that end, the dollar has been weakening in recent months, but Cline believes that it has about another 10 percent to go. “The ideal thing,” Cline said, “would be to pursue a pretty straightforward understanding with [Beijing, Frankfurt, and Tokyo] that they let their currencies appreciate, and we will not have a long-term budget deficit.”

Since U.S. rebalancing with the world will prove almost impossible if China does not also rebalance, the Obama administration will need to deepen its economic dialogue with China. “To prevent rising unemployment caused by the collapse in [its] exports,” said Michael Pettis, a senior associate at the Carnegie Endowment for International Peace, “Beijing has increased the subsidies for [its] domestic manufacturing. As long as Chinese households must subsidize large amounts of [such] inefficient investment, it will be hard for consumption to take off. This will not help rebalance the economy.”

Washington will need to orchestrate international pressure on the Chinese to move faster toward a more domestically driven economy through currency appreciation and efforts to improve wages, and thus domestic consumption, in China.

Of course, the White House will also have a full traditional trade agenda on its plate: The Doha Round of multilateral trade talks remains unfinished, and Congress has yet to approve free-trade agreements with Colombia, Panama, and South Korea.

The United States and other nations are publicly committed to completing the Doha Round in 2010. But, in the words of William Reinsch, president of the National Foreign Trade Council, “the round is like waiting for Godot. I don’t see anything happening there very quickly.”

Moreover, the legislative window of opportunity to pass the free-trade deals will begin closing by midyear, when congressional re-election campaigns kick into high gear, never an opportune time for tough trade votes. Getting Congress to act will require artful renegotiation of the deals to strengthen labor rights in Colombia and improve U.S. automakers’ access to the South Korean market.

Finally, U.S. manufacturing interests are pressing to include duties on carbon-intensive imports in climate-change legislation, which has now slid into the 2010 legislative calendar. Such tariffs-at-the-border measures are opposed by much of the U.S. business community, China, and India, but they may prove necessary to obtain congressional approval of a big energy bill.

So, procrastination has not shortened the administration’s 2010 trade agenda. It has lengthened it.

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