The Huffington Post

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Posted: September 14, 2010 09:07 AM

Jobs, Trade, and Mercantilism - Part II - Dealing With Reality

Read Part I here.

Our massive trade deficit is destroying significant segments of American industry and eliminating badly needed jobs. This is happening because we are slow to recognize an unpleasant reality: We do not live in a world of textbook free trade. We live in a world where our trading partner China has chosen mercantilism and is using the full powers of its government to advance its industries in ways that destroy ours.

If we continue to turn a blind eye to this reality we will become a poor nation.

However we can deal with our trade deficit; we can balance trade. We will describe two ways to do this and there may be more.

Balancing Trade

Tariffs must immediately come to mind as a way to balance trade so we will consider tariffs first. Then we will describe an approach we call BT/BC that is much less well known but may have major advantages.

Both approaches meet the two criteria we laid out at the end of Part 1: first, that the actions we choose should be under our control and not require the cooperation of our mercantilist partner, and second, that the actions we choose should be effective; they should actually balance trade.

Tariffs

Tariffs have a long and checkered history reaching back through centuries. In the United States no discussion of tariffs is complete without mentioning the Smoot-Hawley tariff of 1930. There are many who credit this tariff with making the great depression worse. Then there was President

Nixon's 1971 tariff that was an across the board tariff imposed to compel Japan and other nations to appreciate their currencies. It is generally credited with doing that.

Tariffs meet our first criterion; they can be enacted, repealed or modified by the United States without the consent of our trading partner. Whether they are compatible with WTO Article XII, which permits extraordinary actions in the face of severe and continuing trade imbalances, is something that can be argued.

Tariffs have the great advantage of being flexible; they can be applied to different countries or to different classes of goods. They can be high or they can be low. If initially they don't seem to be producing the desired result, they can be made higher, so that in that sense they can be said to meet our second criterion, they can get the job done, they can balance trade.

However it is the effect of tariffs on the scale of trade that is their major drawback. Tariffs tend to diminish trade, and therefore its benefits. There is also the unpleasant possibility that tariffs could trigger a trade war in which countries react to their trading partner's tariffs with tariffs of their own. This is the effect that followed the U.S.'s imposition of the Smoot-Hawley tariff.

In an extreme case one can imagine trade being balanced by tariffs, but balanced at some level far below its pre-tariff-war level. It is this potential for tariffs to limit or even eliminate trade that make tariffs so extremely unpopular among economists.

The Role of Economists

Economists matter. They often directly formulate government economic policy and their thinking influences government actions indirectly as well. Economists do not want a world economy in which tariffs and counter-tariffs cut off the benefits of trade in which they strongly believe and which they have taught with pride to generations of students.

The usual thing proposed to balance trade is tariffs; since economists are against tariffs, they tend to be against these proposals and to use the dreaded label of protectionism against them.

But is it really true that economics has nothing to suggest toward countering mercantilism beyond opposing tariffs? Fortunately the answer to that question is no. There is in fact a well-known piece of economic thought that is worth considering in countering mercantilism.

The Concept of Cap and Trade

In advocating balanced trade in his remarkable 2003 Fortune article, Warren Buffett described the use of what he called *import certificates*. In various writings and in Congressional testimony University of Chicago Professor Robert Aliber has discussed a similar concept he called *points*.

Both proposals have much in common with a well-known economic concept called *Cap and Trade* that is used not in international trade but in the context of pollution control, to set a limit on pollution.

In Cap and Trade permits to pollute are either issued or auctioned to companies that emit pollutants. Companies must obtain enough permits to cover their emissions. If they can reduce their emissions they can sell their permits to others. Pollution can then not exceed the total of all the permit amounts issued; this is the cap.

When we apply this same concept to international trade; we will call it BT/BC. BT/BC can either stand for Balancing Trade By Certificates, or equally well for Balancing Trade with Buffet Certificates.

BT/BC

Here is an example:

Suppose that a company exports $1 million worth of goods or services produced in the U.S. By doing that the company earns a certificate stating that it has exported $1 million. These certificates are then traded on an open market. Anyone who wants to import into the U.S. is required to have certificates with total face value equal to the value of the proposed import.

This produces balanced trade very directly as the total value of imports is limited to the total value of certificates available and that is the total value of exports. Thus the export total plays the role of the cap in limiting imports.

Properties of the BT/BC Approach

BT/BC, like ordinary tariffs, is a very flexible approach and many variations are possible. Like tariffs it could be applied to specific nations or to specific classes of merchandise or in special situations or to all of these. The price of the certificates sold could go to the producers or in part to the government. Balancing trade could be introduced gradually by initially giving more than a dollar of imports for each dollar of exports, but decreasing that amount over time.

However, and this is important, unlike ordinary tariffs, the direct effect of BT/BC is not to lower or eliminate trade but to lower or eliminate the *imbalance* of trade.

To make this more concrete, let us imagine that the U.S. decides to balance trade with the set of countries with which we have had persistent large trade imbalances. We will call this group China+. Here are some observations:

1. When BT/BC is fully applied trade is balanced.
2. The market price of the BT/BC certificates is an incentive to U.S. producers to export. This translates into jobs in this country.
3. The market price of the BT/BC certificates makes the China+ group's goods more expensive in the U.S.
4. There is an incentive for the China+ nations to import U.S. goods, because that in turn will increase their own ability to export to the U.S.

5. Should the China+ group respond with certificates of their own (a certificate war) they are simply moving the world toward balanced trade. Should they decide to respond with tariffs, they will be acting to reduce their own exports as well as ours.

Other Comments on BT/BC

With a BT/BC plan the China+ nations can avoid massive expenditures on certificates either by decreasing exports to us or increasing imports from us. The option of decreasing exports would allow us to regrow our industries, while the option of increased imports from us would provide export based jobs here with no decrease in imports. In this case the increase in our exports would tend to drive down the price of certificates so that the real world might well come close to the world of textbook trade where trade is naturally balanced.

BT/BC is very much in line with the spirit of both the IMF and the WTO. The IMF states in Article I of its charter that one of its purposes is the *balanced* growth of international trade, while the WTO states in its preamble the aim of securing *reciprocal and mutually advantageous* trade.

Conclusion

Part I described the need to balance trade to stop the destruction of American industry and to create jobs. Part II has described two methods, ordinary tariffs and BT/BC, that we can use to balance trade. While BT/BC seems to have many advantages, tariffs have more history.

Mercantilism is not going to go away. We must find a way to deal with its consequences despite the fact that powerful sectors of our society benefit from the present situation and therefore oppose change.

If we are willing to face up to the reality of mercantilism we will find ways to arrest out nation's downward slide.

But we should act before it is too late.

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