

COMMENTARY



CHINA FINANCIAL MARKETS

# How Trump's Tariffs Really Affected the U.S. Job Market

A recent study on U.S.-China trade concludes that Trump's trade policies cost the U.S. economy nearly a quarter million jobs. But its obsolete understanding of trade flows ends up pointing trade policymakers in the wrong direction.

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A January 2021 [study](#) commissioned by the U.S.-China Business Council (USCBC) claims that former president Donald Trump's trade policies cost the United States 245,000 jobs. As a [Reuters news report](#) put it, the USCBC claimed that "a gradual scaling back of tariffs" could help stop the bleeding, while also arguing that a failure to do so would lead to even greater job losses and more sluggish growth.

But while I have long argued that Trump's approach to trade harmed the U.S. economy more than it helped, this is mainly because these trade policies were based on obsolete ideas about how trade works and because they ignored the fundamental sources of the U.S. trade imbalances. As Matthew Klein and I argued in [Trade Wars are Class Wars](#), bilateral tariffs on Chinese goods do nothing to change the income distortions in China that spurred the country to run huge surpluses and export its deficient levels of domestic demand. Nor do such tariffs address the mechanisms that send these demand deficiencies to American shores. As a result, even if Trump's tariffs were to succeed in reducing the U.S. bilateral deficit with China, they would simply cause the U.S. deficit with the rest of the world, along with China's surplus with the rest of the world, to rise by at least as much.

Clearly, the Trump administration's trade policies were not successful. American deficits with China and the rest of the world were higher last year than they had been in over a decade. And while it is a little unfair to consider 2020 data without recognizing the peculiar economic distortions created by the coronavirus pandemic, U.S. trade and current account deficits were much higher during Trump's presidency than they had been under former president Barack Obama.

But these tariff policies did not backfire for the reasons the USCBC report claims. The main problem is how they mismeasure the benefits of trade. The report identifies several components of the trade relationship (U.S. imports from China, U.S. exports to China, U.S. investment in China, and Chinese investment in the United States) and tries to count up the direct jobs associated with each of these components. They then try to measure the impact of trade policies on each of these components and then tally the estimated job losses. The summary they provide shows how they do this:

*The US has benefited from trade and investment flows with China. The combination of bilateral trade, investment, and supply chain integration has supported economic growth, consumer choice, and job creation. In 2019, exports to China supported 1.2 million jobs in the US and as of 2018, 197,000 people in the US were directly employed by Chinese multinational firms. US companies invested \$105 billion in China in 2019, and the profits from these investments and the contribution they make to the competitiveness of US businesses help support the US economy through R&D, domestic investment, and dividend payments. With China forecast to drive around one-third of global growth over the next decade, maintaining market access to China is increasingly essential for US businesses' global success.*

## Trade Clears Globally, Not Bilaterally

The first and perhaps most obvious problem with this approach is it assumes that trade clears bilaterally. This may have been largely true 150 years ago, when transportation costs were too high to allow production across many locations, but it has become less true over time. In the first chapter of our book, *Trade Wars*

*Are Class Wars*, Klein and I discuss how the global collapse in transportation, communication, and travel costs beginning in the 1980s has made bilateral trade a mostly useless measurement. Imbalances in one country are far more likely to be transmitted to another country indirectly, through other (sometimes multiple) parties, than directly through the bilateral account.

Even if we knew what to count and how to assess its employment impact, in other words, it would be meaningless to limit the discussion of the costs and benefits of trade with any one country solely to that bilateral trade account. To hammer this point home, my mentor at Columbia University, the late Michael Adler, once glared angrily at his students and warned that if any of them even mentioned bilateral trade they would immediately fail the class. Bilateral trade data convey very little about the overall trade relationship between two countries.

## Imbalances Are Transmitted Mainly Through the Capital Account

There is another compelling reason why bilateral trade data doesn't matter. The globalization of capital flows suggests that trade imbalances are more likely to be transmitted through the capital account than through the trade account. If China, for example, exports excess savings to the United States, U.S. attempts to reduce the bilateral trade deficit with China through tariffs are likely merely to reroute that deficit through other countries. At the end of the day, a reliance on tariffs leaves the overall U.S. deficit unchanged if Chinese capital flows to the United States are unchanged, even when the bilateral deficit with China appears on the surface to shift. That is why it is much more useful to focus on the capital account, and even then, the analysis must start with each country's *overall* capital account, not just its bilateral capital account.

To understand how China affects the U.S. economy, in other words, analysts must focus on how Chinese policies force up domestic savings above domestic investment, and how these excess savings are then exported to the rest of the world. To the extent that they are exported to developing countries in which

domestic investment needs exceed domestic savings (developing countries that are running trade deficits funded by Chinese capital inflows), Chinese imbalances are positive for growth because they raise investment in the recipient country. To the extent, however, that China's excess savings are exported to advanced economies that are not capital-constrained, they merely shift growth from their trade partners to themselves. The impact on the U.S. economy, in that case, would depend on the role the United States plays in absorbing excess global savings.

But things get even more complicated than that. The negative economic impact that these excess savings can have on the U.S. economy can manifest itself as either higher unemployment or higher debt (either household debt or a fiscal deficit). The actual impact depends on how domestic policies are designed to determine whether the United States “chooses” higher unemployment or higher debt.

This is important. The United States can adjust to excess foreign savings in several ways. The only requirement is that the adjustment must lower the U.S. savings rate one way or another. This can happen because imported foreign savings (which are identical to the net import of goods and services) either raises unemployment or raises debt. That is why it isn't at all clear that the right way to measure an adverse trade imbalance is in the number of jobs lost or gained. After all, the necessary U.S. adjustment could just as easily (and more likely) occur in the form of higher household debt.

## Most of the Trade Impact Is Indirect, Not Direct

A further problem with the USCBC methodology is that it seems mainly to count the impact of each component of trade—U.S. imports from China, U.S. exports to China, U.S. investment in China, and Chinese investment in the United States—on direct employment, while ignoring the indirect components. For example, if a tariff on Chinese widgets causes Americans to consume fewer widgets, it is a relatively easy exercise to measure how many American employed in the widget-distribution business will lose their jobs.

But even if Americans buy fewer widgets, that doesn't mean that *total* American consumption is reduced. It just means that Americans will buy fewer widgets and more of other things. That being the case, it isn't at all obvious how tariffs on Chinese widgets would affect American employment overall. What really matters is how tariffs on Chinese widgets affect the relative shares of GDP retained by Chinese and American households.

It isn't hard to understand why most trade analysts prefer to count the direct impact: it seems easier to estimate. But most of both the positive and negative impacts of trade are likely to be indirect, affecting the economy primarily by changing the overall macroeconomic levels of investment and/or savings.

## Deficits Aren't All Created Equal

The USCBC study's methods don't add up in other ways. This kind of trade analysis can't distinguish between the employment impact of nineteenth-century U.S. deficits and contemporary deficits. This matters because the two are categorically different. In the nineteenth century when the United States suffered from capital scarcity, foreign capital inflows boosted U.S. investment. But in the capital-saturated United States of today, excess foreign capital inflows and the deficits they trigger end up reducing savings, not boosting investment.

This difference is hugely important. Basic accounting identities teach that net capital inflows must by definition result in either higher investment or lower savings. Because American trade deficits that result in higher investment cannot possibly have the same impact as American trade deficits that repress savings, there are serious problems with a methodology that cannot distinguish between the two.

More generally, trade theory tells us that trade deficits can be positive for developing countries whose high investment needs exceed domestic savings, whereas mature, advanced economies are not supposed to be able to run large, persistent deficits. A research methodology that cannot distinguish between the two paints a very skewed picture. The same problem emerges, in an even worse way, when analysts assume that the employment impact of Chinese investment

in the United States is equal to the number of jobs in Chinese-owned businesses. This could only be true in an economy with very high costs of capital in which demand is held down by supply side constraints. Those conditions clearly don't apply to the United States of the past four years, when capital has been cheap and abundant and the main constraints have been on the demand side.

To sum up, deficits can be either positive or negative for growth and unemployment depending on the underlying macroeconomic conditions. A research methodology that fails to notice or account for this is likely to miss the big picture.

## Surpluses Are Usually the Consequence of Suppressed Wages

By focusing on the employment impact of each independent component of trade, the USCBC analysis seems unable to distinguish between the employment impact of foreign trade on countries running large surpluses versus the impact on those running balanced positions or large deficits. Yet it is obvious that countries that run large surpluses do so to generate jobs that cannot be economically sustained by meeting domestic demand alone.

This tendency to conflate unlike trade effects effectively misses the point. They do not ignore the impact of imports altogether, but their methodology seems to assume automatically that imports increase real household income (by lowering the prices of consumer goods) by more than they reduce household income through direct job losses. Meanwhile, they simultaneously ignore the ways imports can repress wages or raise indirect unemployment, along with the indirect job losses caused by this wage suppression.

In nearly every country running large, persistent surpluses, the household share of GDP is lower than that of peer countries and trade partners. This isn't merely a coincidence. It is low wages relative to productivity that allows countries to run surpluses, and yet the USCBC analysis seems implicitly to deny that countries increase international competitiveness mainly by directly or indirectly reducing the wage share of production, or that when countries implement policies to

improve what they deem international competitiveness, this is usually nothing more than a euphemism for policies that directly or indirectly suppress wages.

That is why they find that more trade can only result in higher real household income. They exclude the possibility that, to the extent a surplus country relies on lowering wages to become competitive enough to run its surplus, it must put downward wage pressure on its trade partners.

## Foreign Profits Don't Generate Domestic Investment Windfalls

The USCBC report claims that U.S. companies earn profits on their Chinese investment that they then funnel into increased American investment. But again, this assumption ignores the crucial distinction between economies where business investment is constrained by high capital costs and economies where investment is constrained by weak demand. Many multinational American companies are already sitting on huge hoards of cash for which they cannot find a productive use: that hardly seems to indicate that American businesses need foreign profits to fund even more investment at home.

## Trade Is More Than Ideology

The USCBC study concludes with the following:

*Scaling back tariffs would likely benefit the US economy and create jobs. Even a moderate rollback in tariffs could increase economic growth and stimulate employment growth. Under our trade war de-escalation scenario, where both governments gradually scale back average tariff rates to around 12% (compared with around 19% now), the US economy produces an additional \$160 billion in real GDP over the next five years and employs an additional 145,000 people by 2025. US household income would be \$460 higher per household as result of increased employment and incomes as well as lower prices.*

*Escalating trade tensions and significant decoupling with China would hurt the US economy further and reduce employment. Our trade war escalation and decoupling*



*scenario sees the US economy produce \$1.6 trillion less in real GDP terms over the next five years and results in 732,000 fewer jobs in 2022 and 320,000 fewer jobs in 2025. In addition to a significant near-term shock to economic output, long-term effects would permanently lower GDP, reflecting lower economic productivity. By the end of 2025, US households will have lost an estimated \$6,400 in real income.*

This is an admirably precise set of conclusions and projections about the supposed impact of their recommendations, but the USCBC's methodology does not support them. Their analysis focuses mostly on minor or irrelevant data and almost wholly ignores the key issues at play.

The idea that trade deficits are always bad, or always good, is just ideology. Deficits can be positive for growth under some conditions and negative for growth under other circumstances. An analysis that cannot distinguish between the two sets of conditions is bound to discover only whatever it sets out to discover and bound to reach conclusions that cannot be trusted.

A far sounder way to gauge the impact of Trump's tariffs would be to focus instead on questions like these:

- What economic distortions are causing China's high savings?
- How much of China's excess savings are exported as productive investment to capital-constrained economies and how much are shipped to capital-saturated economies due to deficient demand in China?
- How much of these excess savings does the U.S. economy absorb?
- To what extent do these capital inflows boost U.S. investment or reduce U.S. savings?
- If U.S. savings are curtailed, are these changes driven by higher unemployment, more household debt, or a greater fiscal deficit?

Without accounting for the ways capital and trade flows have changed in the twenty-first century, analysts cannot hope to accurately project the likely ramifications of trade policies like the Trump administration's tariffs.



*Aside from this blog, I write a monthly newsletter that focuses especially on global imbalances and the Chinese economy. Those who would like a subscription to the newsletter should write to me at [chinfinpettis@yahoo.com](mailto:chinfinpettis@yahoo.com), stating affiliation. My Twitter handle is @michaelxpettis.*

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