

The U.S. Trade Deficit: Myths and Realities

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The views expressed herein are mine and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

Some context



Trump escalates global trade war with new 25 percent automobile tariffs

The president's plan will probably drive car prices up. The White House says the goal is to bring car manufacturing back to the United States.

BY DAVID J. LYNCH
MARCH 26 AT 7:03 PM

Some context

- ▷ impact of tariffs: first order policy question these days
- ▷ uncertainty about the size of tariff increase, but even conditional on numbers hard to assess impact on trade deficit, jobs, inflation
- ▷ one reason why it is hard is that tariffs are at the intersection of trade/micro and macro
- ▷ Trade/micro models: detailed analysis of impact on prices, maybe sectoral allocation, but much less on macro variables (inflation, trade deficit)
- ▷ Macro models: some (Barattieri et al, 2021 Bergin and Corsetti 2023, Bianchi and Coulibaly 2025, Kalemli-Ozcan et al. 2025), but less about job reallocation

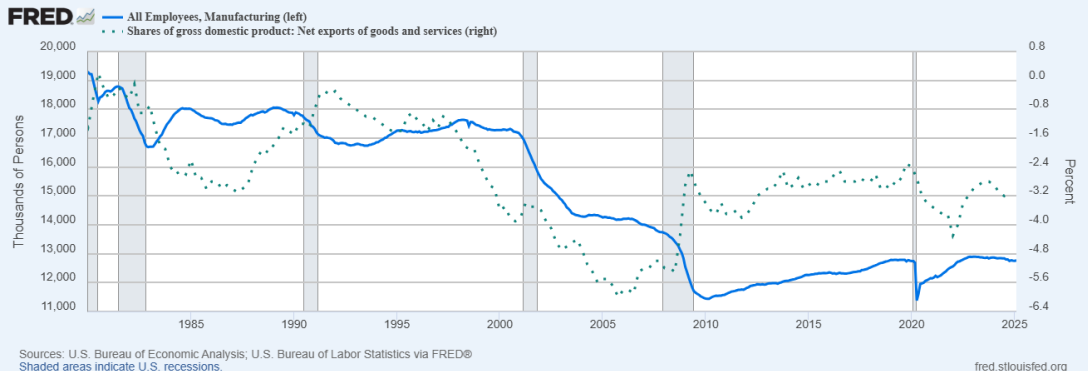
Why tariffs?

- What's the main rationale behind tariffs?
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- Is it to improve the trade deficit? Yes and no
- Autor, Dorn and Hanson, 2013 (China Syndrome) have emphasized the connection between loss of jobs and import competition
- These findings used as a rationale for tariffs: bring back the manufacturing jobs in the heartland and improve the trade deficits!

Trade deficits and manufacturing jobs



Lessons from Maury's paper

- It stresses tariffs not obviously connected with trade deficit.
 - Tariffs make foreign goods more expensive
 - Consumers will buy less of them
 - Not at all obvious how they are going to affect intertemporal income, consumption and investment profiles, which ultimately determine the trade deficit (current account)
 - For example: if tariffs perceived to be temporary and they temporarily depress domestic output, they might actually lower the current account!
- Compelling narrative regarding the drivers of 1998-2008 trade deficits

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- Compelling narrative regarding the drivers of 1998-2008 trade deficits
- However, how about jobs?

Outline of discussion

- ▷ Simple unified-framework to analyze interactions between tariffs, macro, trade deficits and jobs
- ▷ Some concluding thoughts on the U.S. trade deficits

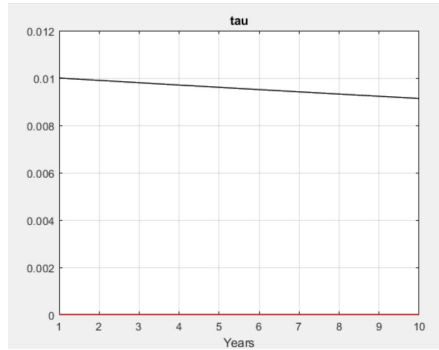
Sketch of the framework

- Extends standard Armington set-up, to allow for production of both import and export competing goods
- Two countries: (US and Them)
- Two goods/services: Uber-rides, and Toys
- Both countries produce (using labor and capital) varieties of U and T , US more productive at Uber-rides, Them more productive at Toys
- Final Goods: $F(G(\text{Uber}, \text{Uber}^*), G(\text{Toys}, \text{Toys}^*)) = c + i_T + i_U$
- Inputs in F : complements, Inputs in G : substitutes (role for tariffs)
- Costly reallocation of labor across sectors
- Standard country specific TFP shocks, international trade in bonds
- Large cross holdings of stocks (capital) of producers (Atkeson et al., 2024)

$$c_t + q_t b_{t+1} = w_{Ut} l_{Ut} + w_{Tt} l_{Tt} + \lambda(d_{Ut} + d_{Tt}) + (1 - \lambda)(e_t d_{U^*_t} + e_t d_{T^*_t}) + b_t$$

Main experiment

- ▷ Permanent increase in tariff on Foreign Toys (without retaliation)



Results, 1

- ▶ Positive impact on jobs in US TOYS, but negative on US UBER (the aggregate number of jobs can go both ways), negative aggregate welfare and productivity
 - ▶ Tariffs make foreign toys more expensive, reallocation of U.S. workers from Uber (more efficient) to Toys (less efficient).
- ▶ Positive but small impact on trade deficit, driven by fall in investment/capital
 - ▶ Imports falls, but exports fall as well as less workers in US Uber sector. However US wants to shed capital, increased saving in bonds

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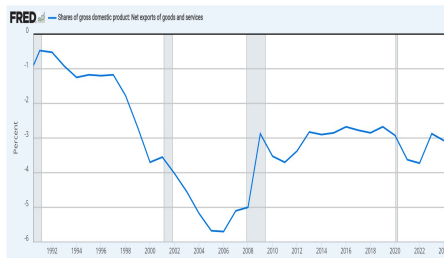
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 - ▶ Imports falls, but exports fall as well as less workers in US Uber sector. However US wants to shed capital, increased saving in bonds
- ▶ Negative impact on NIIP: valuation effects, through US real exchange appreciation triggered by tariff

Second Experiment

- ▷ Assume retaliation, and consider responses to standard productivity shocks in a world with high and low tariffs
- ▷ With higher tariffs, smaller deficits in response to standard productivity shocks (Bai et al, 2025, Krugman, 2025)
- ▷ So, in a sense, tariffs do reduce trade imbalances, but at what cost?

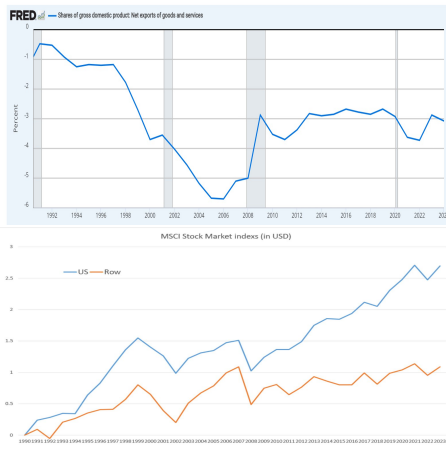
Final considerations on the U.S. trade deficits

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- ▷ Since 1990 U.S. has been running a large trade deficit..
- ▷ ..deficit has financed (among other things) U.S. investment..
- ▷ ..returns to U.S. investment have resulted in two U.S. centered technological breakthroughs (Internet and AI)..
- ▷ ..which have resulted in much higher U.S. market valuations..
- ▷ which have been shared by RoW through massive increase in international equity diversification!



Final considerations on the U.S. trade deficits

- ▷ Obviously hard to run counterfactuals, however this longer run view suggests that
- ▷ with a less open current account the U.S. would have invested less, and as a result the U.S. (and the world) today would not be at the same level of development we're in now!
- ▷ looking forward, more worries from high tariffs than high trade deficits!