



A Balancing Act

How to End America's Trade Deficits

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The U.S. trade profile for March shows that the country is in recovery mode. Imports increased at a level comparable to November 2008, and the deficit widened. This is a reminder that the United States may once again have to face growing current account deficits on the order of periods past. The trade deficit with China is slowly picking up steam, exceeding the \$50 billion mark for the first three months of this year, while the level of oil imports continues to be stubbornly high.

Addicts are never the sole victims of their addiction, and so it is with America's biggest bad habits. America's addiction to cheap Chinese imports threatens global economic stability, just as our addiction to imported oil threatens the world's climate.

But addiction is usually profitable for someone, which is one reason bad habits are so hard to shake. In this case, the Chinese refuse to let the value of their currency rise, which dampens U.S. demand for their goods. Oil exporting nations, meanwhile, are unlikely to help wean us from their products, since they reap the profits while others bear most of the costs.

Americans seem to lack the political will to address either of these costly challenges. But there is a tool at hand that can help. We need to adapt the cap-and-trade systems that have worked well in other arenas (e.g., combating acid rain) to bring our imports into line—not only for America's own good, but for everyone else's as well.

The plan is fiendishly simple. Every dollar of U.S. exports would generate a point redeemable for the right to bring a dollar's worth of foreign products into the country. Importers would buy these points at auction from the U.S. government, which could use the money to lower the payroll tax that currently pays for Social Security and Medicare.

Under this plan, imports could never exceed exports—unless, of course, the government saw some need to run a trade deficit, in which case it could just sell off more points. Allocation of these import rights would be easy. The auction would award them to the highest bidder, for whom they would presumably have the greatest value. One great feature is that the government would not have to decide which products or nations to favor with more import rights—a process that would quickly become Byzantine and corrupt. The auction process would solve this predicament.

America's trade deficits with China—nearly \$227 billion last year alone—might persist, but only if we ran a trade surplus with other countries. To ensure balanced growth and full employment, overall trade would have to be in balance. Since importers of oil would have to compete for points with importers of everything else, the system

would apply a natural brake to harmful fossil-fuel consumption. This would be good for national security as well as the environment.

Furthermore, the plan offers a way to reduce the regressive payroll tax on which America's social safety net depends. Doing so would stimulate the economy perhaps enough to offset the negative impact of higher import prices. In effect, the U.S. government would be reimbursing the American consumer for whatever domestic pain the plan might cause.

As is the case with many ideas, some version of this one has been proposed before—by no less than Warren Buffett, who advocated a system of import certificates that would be awarded to exporters and traded on a secondary market. But why bestow these valuable import-rights coupons on firms that happen to be in the export business? Why not use them instead to put money back in the pockets of consumers by cutting their taxes and lowering employment costs?

Astute observers will note that, although this plan relies on a proven cap-and-trade principle, it will look a lot like a tariff to U.S. trading partners, who might well retaliate. But they would be foolish to do so. Our trading partners are the great beneficiaries of the current system, and they would have no great incentive to destroy it just because it grows somewhat less advantageous to them. On the contrary, free trade is wonderful, and this plan would help ensure that China and other countries actually engaged in it.

Now that America's financial institutions have been brought back from the brink, the greatest threat to global economic stability is the gigantic trade imbalance between the United States, China, and other trading partners. A second big threat to economic stability, in the longer run, is global warming. Both problems are related to America's bad habits, and a clever cap-and-trade system could help us kick them at last.

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