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Trump can make stronger growth or a smaller trade deficit a priority, but not both.

When Two Economic Goals Collide

CAPITAL ACCOUNT

By Greg Ip

Wall Street is glued to "The Apprentice: Treasury Edition." The auditioning for President-elect Donald Trump's Treasury secretary isn't just great theater. Trump's choice will be key to where his economic agenda is headed.

There are two main planks to that agenda: tax cuts and deregulation to bolster economic growth; and tariffs to reduce the trade deficit and bring back factory jobs.

The problem is that these two planks are in conflict. Faster growth and bigger budget deficits boost imports and the dollar, widening the trade deficit and making U.S. manufacturers less competitive. Tariffs dent consumer spending and business confidence and put upward pressure on inflation and interest rates, undermining growth. Trump can make stronger growth or a smaller trade deficit his priority, but not both.

This is where his Treasury pick comes in. The hedgefund manager Scott Bessent, until recently the front-runner for Treasury, and Howard Lutnick, chief executive of the financial firm Cantor Fitzgerald, nominated to be commerce secretary, have called tariffs a negotiating tool, which presumably means tariffs won't go up that much once other countries make concessions. Former Federal Reserve governor Kevin Warsh is a free trader.

If any of these three were the primary driver of Trump's economic policies, then that favors lower taxes and not much in the way of tariffs. The views of two other candidates— Marc Rowan, chief executive of the private-equity giant Apollo Global Management, and Tennessee Sen. Bill Hagerty—are unclear.

Who would be pressing for higher tariffs? The betting has been on Robert Lighthizer. As trade ambassador in Trump's first term he oversaw the rollout of tariffs, including on China, and negotiated trade deals with Canada, Japan, Mexico and South Korea. He has a deep knowledge of trade law and close ties with legislators in both parties.

But the Trump transition team said Lutnick would oversee trade, leaving it unclear if Lighthizer will have a role. That would leave Trump without his most effective advocate for tariffs. That could be offset somewhat by Peter Navarro, another hawkish adviser said to be in the running for a position.

Markets seem to be betting on the growth agenda, with a smattering of tariffs on the side. Scott Chronert, equity strategist at Citi, delved into the market rally since Election Day and concluded that investors expect free cash flow growth in the next five years to average 1.2 percentage points faster as a result of Republican control of Congress and the White House.

He attributed about half of that to expectations of the corporate tax rate being lowered to 15% for domestic producers from 21%, and the other half to deregulation and lower household taxes.

Meanwhile, European and Chinese stocks have dropped since Election Day, and the euro and yuan have weakened against the dollar in anticipation of actual or threatened trade war.

But markets don't seem to expect the 60% tariffs on China and 10% to 20% on everyone else that Trump promised during the campaign.

Nonetheless, a stronger dollar and weaker foreign growth would depress U.S. exports (as would retaliation against U.S. tariffs), further undermining Trump's goal of a smaller trade deficit.

JPMorgan Chase economists assume that Trump will go ahead with a steep tariff on China, but not everyone else. Such a move, they figure, will lower Chinese growth by 0.8 percentage point, and lead to a 10% to 15% drop in the value of the yuan.

The bank expects U.S. growth to slow from 2.8% this year to a still robust 2.2% next year. And it sees the broadest measure of the trade deficit, including goods, services and investment income, widening slightly from just under $1 trillion this year to a little over that level next year and in 2026.

"Policymakers here are going to have to decide what their priorities are and how to balance things," said Bruce Kasman, chief economist at JPMorgan. "We're generating a dynamic that is hurting foreign and helping U.S. growth and pushing the dollar up. It's not that surprising that you don't get a beneficial effect on trade."

When a country spends more than it earns, it runs a trade deficit that it finances by selling assets, such as government bonds, to foreigners. So if reduced regulation and taxes boost investment and household spending, imports will rise and the trade deficit will expand, all else equal. Meanwhile, foreigners buying the U.S. bonds that finance the trade deficit will push the dollar higher, further widening the trade gap.

That's what happened in Trump's first term. Despite higher tariffs, the trade deficit grew by 17% between 2016 and 2019. In that time, the dollar also rose, and the Tax Cuts and Jobs Act, which Trump signed into law in 2017, fueled a 68% widening in the federal deficit.

Many of that law's provisions expire at the end of next year, and Trump and congressional Republicans plan to extend them, at a cost of about $5 trillion over a decade, according to the nonpartisan Committee for a Responsible Federal Budget. Trump has also proposed a raft of other tax cuts and spending increases, bringing the total deficit impact to around $8 trillion.

The Penn Wharton Budget Model estimates that Trump's plans to extend the 2017 tax cuts, lower the corporate rate and repeal taxes on Social Security benefits would boost the annual trade deficit by about $800 billion over the coming decade.

Kent Smetters, the group's head, said foreigners buy about 20% of newly issued U.S. debt. Trump's "desire to have a weak dollar is not going to be compatible with extending the tax cuts unless there are pay-fors along the way."

Elon Musk and Vivek Ramaswamy say they can slash bureaucracy and spending. But Congress is notoriously resistant to meaningful spending cuts. Some advisers say Trump can "impound," i.e., refuse to spend, money appropriated by Congress, but that is legally dubious.

That leaves tariffs. But they would have to rise as much as, or more than, Trump has threatened in order to provide meaningful revenue. And the higher the tariff, the greater the hit to consumers and businesses (who pay most of the tariff), and the greater the impact on inflation.

A complete economic team will give some sense of where the balance is struck between tariffs and everything else. But it will be an imperfect guide to Trump's actual policy. That has always been what Trump alone wants it to be.

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