The spectacular economic ignorance of Peter Navarro

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Those who believed President Donald Trump's trade policy couldn't be as bad as suggested might want to reassess. For his adviser Peter Navarro has written a spectacularly economically ignorant article on the subject for the *Wall Street Journal*, fulfilling all of Robert Colvile's fears.

His premise is simple: trade deficits are a drain on economic growth, and the capital surpluses necessary to finance them are also harmful to American interests.

Where to start?

1) Navarro does not understand GDP

He begins: "Growth in real GDP depends on only four factors: consumption, government spending, business investment and net exports (the difference between exports and imports). Reducing a trade deficit through tough, smart negotiations is a way to increase net exports – and boost the rate of economic growth."

But the GDP identity he talks of (think Y = C + I + G + X – M) is not a growth equation, and imports do not "reduce GDP". The reason that imports are subtracted from the equation is because they are already embedded in the spending of households, businesses and governments. To leave them in there would mean GDP would be overstated by double-counting imports, when in fact imports are not domestically produced. In fact, higher imports tend to be associated with faster growth – they are not a drain on it.

2) Navarro seems to think exports of goods are more important than services

All the time, he refers to a persistent deficit in "trade in goods". But the US exports services too. In fact, it runs a surplus in them of close to $300 billion. That Navarro has a fetish for manufacturing is a personal issue, but exports generate foreign earnings whatever you're producing. whether it's cars or selling insurance or producing a Hollywood movie. In terms of the actual totals, the composition of exports does not matter at all.

3) Navarro implies that trade deficits are always a problem

Navarro simply points at accounting identities and at a trade deficit to imply that it engenders economic weakness. For sure, trade deficits *can* be a symptom of problems, but his mechanical view that they *must* be does not hold.

If a country imports more dollar-value goods and services than it exports, it is a result of the individual decisions of its population and the population of the rest of the world. Those imports can be paid for by export earnings, by running down savings or by borrowing. That's why any trade deficit (net outflow of dollars) is matched by an investment surplus (net inflow of dollars).

A current account deficit is really just an aggregate decision to spend more than your income – the wisdom of doing so really depends on what that borrowing, or the inward investment associated with it, is used to finance.

In the late 19th and early 20th century, for example, the US ran current account deficits as money poured in to invest as industry expanded to the west.

In fact, the US has run trade deficits for the past 41 straight years. As my colleague Dan Ikenson has outlined, this is "a period during which the size of the American economy tripled in real terms, real manufacturing value quadrupled, and the number of jobs in the economy almost doubled".

Now, current account deficits can be caused by excess demand, as loose monetary policy leads to rising prices at home and more purchases from abroad. But Navarro provides no evidence for this being true today. If it were, we'd expect it to put substantial downward pressure on the dollar, which doesn't seem to be happening.

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4) Navarro seems confused on how a trade deficit interacts with investment

As Tim Worstall has noted, Navarro is desperate to say that America's trade deficit is in part caused by offshoring, and lower domestic investment. But he then acknowledges, as outlined above, that the flipside of current account deficits is capital account surpluses and thus investment into the US from abroad.

This can manifest itself in purchases of equities or physical assets, or government or corporate debt. Only a portion of these, though, are really generalised debts owed by the American public to foreigners – and that is the portion associated with financing of government borrowing (which could be reduced if the federal government decided to rein in its borrowing).

But one simply cannot imply, as Navarro does, that trade deficits are associated with lower investment, unless one thinks American investment is more worthy than investment from abroad.

In short, Navarro thinks imports reduce GDP. They don't. He thinks some overseas earnings (those from goods) matter more than others (services). They don't. He thinks a current account deficit is automatically a problem. It isn't. He thinks that domestic investment in the US is somehow better than foreign. It isn't. He thinks that pointing at accounting identities is economics. It isn't.

If used to inform policy, such an agenda would lead to huge capital flight from the US and deeply damaging new trade restrictions, raising prices and reducing choice for US consumers.

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