Trade chief's policies could be disastrous for Eurozone

Dalibor Rohac

March 9, 2017

According to Peter Navarro, the top trade advisor to the Trump administration, the $65 billion U.S. trade deficit with Germany is “one of the most difficult” trade issues facing the nation, which will have to be addressed bilaterally outside of the framework of the European Union (EU).

Set aside for a moment the fact that trade policy is part of the exclusive competence of European institutions, not of member states, which makes the meaning of Mr. Navarro’s remarks hard to decipher. More importantly, he reveals an unhealthy mercantilist obsession with trade deficits, illustrated by his controversial opinion piece in the Wall Street Journal last Sunday.

In short, Mr. Navarro confuses the simple accounting relationship between GDP and net exports (the difference between the value of exports and imports) with a causal, economic link. That leads him to believe, wrongly, that the U.S. economy can be expanded simply by boosting net exports — by exporting more, by importing less, or both.

However, imports into the United States are part of a story much more complicated than Navarro’s accounting exercise would lead one to believe. For starters, imported goods often serve as inputs into production in the United States.

Then, the dollars paid by Americans for goods and services from overseas can be used to buy dollar-denominated assets, thereby boosting another component of GDP — investment.

For over four decades, the United States has recorded a trade deficit. Throughout much of that period, writes Dan Ikenson, the director of Cato Institute's Center for Trade Policy Studies, "annual changes in the value of imports and the value of GDP moved in the same direction."

This is because importing more does not simply reduce net exports — it also provides inputs for domestic production and boosts investment.

As Germany accumulates growing trade surpluses, it is also a net exporter of capital. German savings, in other words, are looking for productive uses abroad, with a higher rate of return than what the domestic economy has to offer.

Going aggressively after the U.S. trade deficit with Germany would thus mean going after the Volkswagen plant in Chattanooga, Tennessee, the Mercedes plant outside of Vance, Alabama, the BMW factory in Greer, South Carolina, or the Siemens Service Center in Houston, Texas.

Of course, the story of Germany's trade surpluses has a twist — the euro. But the problem is not, as Navarro said in January, that the Germans would be using a "grossly undervalued" euro to flood the U.S. with German goods. In fact, such terms make little sense in a world of market-determined exchange rates, such as the one between the dollar and the euro.

The problem that the euro poses rests within the Eurozone. After the creation of the common currency, Germany's capital exports helped finance unsustainable borrowing on the Eurozone's periphery.

Because they were part of the same monetary union, countries such as Greece and Spain couldn't let their currencies depreciate when the crisis hit — they don't have their own currencies.

Instead, they had to go through a painful process of deleveraging and fiscal austerity, administered by the Troika—the European Commission, the European Central Bank and the International Monetary Fund.

The consequences were severe. Over the past decade, Greece has lost almost one-third of its per capita GDP. Between 2008 and 2013, unemployment increased from roughly 7 percent to almost 28 percent, and hundreds of thousands, including the best and the brightest, have left the country in search of economic opportunities abroad.

These, however, are problems that affect Europeans, not Americans. It is up to the Europeans to solve them by creating a system of fiscal transfers across the Eurozone, by reforms that would increase mobility and flexibility of labor markets, or by allowing chronic underperformers, such as Greece, out of the Euro.

Navarro's presumed fix to Germany's trade surplus "problem" is a stronger euro. However, it was exactly Germany's commitment to low inflation that prevented the European Central Bank from responding to the economic catastrophe unfolding in Greece with a timely monetary stimulus in the early stages of the crisis.

A monetary tightening in the Eurozone that Mr. Navarro would like to see would be an economic and political disaster for the Mediterranean economies and could easily lead to the Eurozone's chaotic break-up.

Those who wish for such an outcome based on their misunderstanding of the basics of international trade should not be allowed anywhere near the levers of power.