THE WALL STREET JOURNAL.
WSJ

Trade Deficit, GDP Rise and Fall Together

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March 13, 2017

The problem with Peter Navarro's commentary is the assumption that by renegotiating trade agreements, the Trump administration can bring jobs and investment back to the United States.

National Trade Council Director Peter Navarro commits analytical errors and reinforces fallacies in his March 6 op-ed "Why the White House Worries About Trade Deficits." Consider Mr. Navarro's portrayal of the national income identity as an economic growth formula. He claims: "[G]rowth 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."

First, the evidence is overwhelming—month after month, year after year—that the trade deficit and GDP rise and fall together. The largest ever decline in the annual U.S. trade deficit occurred in 2009, the trough of the Great Recession. Second, growth in real GDP (the total value produced in the economy) depends on increases in the factors of production and increases in the productive use of those factors, which trade and specialization facilitate.

The national income identity is expressed as: $Y=C + I + G + X – M$. It tells us that our national output is either consumed by households (C); consumed by business as investment (I); consumed by government as public expenditures (G); or exported (X). Those are the only four channels that can account for the disposition of national output. We either consume it or we export it.

Imports (M) are not a channel through which national output is disposed, but M is subtracted in the identity because we consume—as C, I and G— both domestically produced and imported value. If we didn't subtract M, we would overstate GDP by the value of our imports.

Mr. Navarro either believes, or would have the public believe, that imports detract from GDP and that our national security requires all of the gears of U.S. trade policy be put to the service of eliminating our trade deficit. Either way, he's wrong.

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