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Beneficiaries of Trade: You and Me

By DANIEL GRISWOLD

America isn't the loser when imports exceed exports, despite popular perceptions to the contrary.

Whenever the U.S. Commerce Department reports rising imports and an expanding trade deficit, the economic priesthood pronounces it bad news for the economy. "Rising trade deficit could drag down economy," is a typical newspaper headline. As the Associated Press summarized conventional thinking a few months ago, "Growth slows when imports outpace exports, because more jobs go to foreign workers."

This is wrong in theory and in practice.

The stakes are high. Misguided worries about imports and trade deficits feed public anxieties, and can lead policy makers to reach for protectionist measures that do more harm than good. They can cause investors to misread the fundamental forces driving growth.

The mistaken assumption that imports and trade deficits are a drag on growth depends on the seemingly plausible idea that anything we import is one less thing we make ourselves. The Bureau of Economic Analysis supports this error in its quarterly estimates of gross domestic product by reporting that a rise in imports always represents a "subtraction in the calculation of GDP."

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Dan Picasso for Barron's

The common fear of trade deficits is unjustified, both in theory and in practice.

Don't believe it. Much of what we import doesn't displace domestic production so much as complement it. Imports fuel American industry by providing the raw materials, intermediate inputs and capital machinery our producers need to compete. Competition from imports spurs innovation, cost containment, and productivity gains. Lower prices for imported consumer goods allow households to spend more on home-grown services.

The dollars we spend on imports quickly return to buy U.S. assets. In 2010, our trade deficit in goods of $647

billion was exactly offset by our trade surplus in services and investment income and our large capital surplus—the amount of U.S. assets, including Treasury bonds, purchased by foreigners, minus the foreign assets purchased by Americans. The grand balance of U.S. international transactions last year, as in every year, was zero.

CONTRARY TO THE BEA'S UNHELPFUL WORDING, a rising level of imports doesn't "subtract" from gross domestic product. The problem is the way by which the government calculates GDP. It doesn't actually count what we produce, but rather what we spend—adding up what the government spends, what households spend, what we invest, and what we export. Imports are already counted in domestic expenditures in a way that makes them indistinguishable from domestic goods and services. If the BEA didn't subtract imports from total domestic expenditures, GDP would be overstated.

So, when the BEA reports that imports "subtracted" two percentage points from economic growth in the past quarter, that doesn't mean that GDP would have grown that much faster without those pesky imports. It only means that other components—private and government expenditures, investment, and exports—were overstated by that amount. The subtraction reduces the overstatement, not real gross domestic product.

In a recent study for the Cato Institute, I tested the conventional wisdom on imports and the economy.

Since 1980, the trade deficit has grown as a share of GDP during five sustained periods: 1982-84, 1992-95, 1997-2000, 2001-06 and 2009-10. It has shrunk during three sustained periods: 1987-92, 2000-01 and 2006-09. I then examined how the U.S. economy performed during each of these periods in terms of real gross-domestic-product growth, equity prices (as measured by the Standard & Poor's 500 Index), manufacturing output, total civilian employment and the unemployment rate.

Contrary to the prevailing orthodoxy, the U.S. economy shows no sign of suffering during periods when the trade deficit is expanding. To the contrary, real GDP grew more than three times faster at an annualized rate—3.6%, versus 1%—during periods when the trade deficit was expanding, compared to those in which it was shrinking.

A rising trade deficit was good news for investors, as well. The S&P 500 climbed an annualized average of 11% during periods when the deficit was "worsening" compared with less than 1% during periods when it was "improving." Despite worries that trade is causing the de-industrialization of America, manufacturing output expanded at a robust 5.2% a year during periods of rising deficits, and shrank by 2% a year when the trade gap was contracting.

People who blame job losses on trade deficits should consider this: Civilian employment expanded at a healthy 1.4% a year during periods of rising trade deficits, while job growth was virtually zero during stretches when the deficit was shrinking. The jobless rate declined an average of 0.4 percentage points per year when the trade gap was on an upward trend, and jumped a painful one point per year when the deficit was trending down. Apparently, the only thing worse for the U.S. economy than a rising trade deficit is a falling one.

Politicians obsessed with the trade balance should give up the goal of promoting exports over imports. The aim of U.S. trade policy should be to maximize the freedom of Americans to buy and sell in global markets for mutual gain, whatever the mix of goods, services and assets we freely choose to trade.

DANIEL GRISWOLD, the director of the Herbert A. Stiefel Center for Trade Policy Studies at the Cato Institute in Washington, is the author of *Mad about Trade: Why Main Street America Should Embrace Globalization*.

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