Navarro's trade views 'misguided', 'dangerous'

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December 23, 2016

To those mindful of history and the laws of economics, this week's appointment of Peter Navarro to head the newly established National Trade Council within the White House is the latest assault on the fundamental premise that public policy should be rooted in fact and reason.

Navarro's misguided views of trade as a win-or-lose proposition and trade policy as an adjunct of warfare represent a dramatic departure from the bipartisan, pro-trade consensus that has guided U.S. policy since the end of World War II.

It's a long-standing tenet of international relations that countries that engage in cross-border trade, investment, and production are less likely to descend into conflagration. Greater interdependence raises the costs – and reduces the temptation – of war.

As the 19th century French business writer Frederic Bastiat is reported to have quipped, "Where goods don't cross borders, Armies will."
But Navarro, a Harvard-trained, University of California-Irvine business professor, fails to see trade as a mutually beneficial activity between willing parties, which reinforces the ties that bind.

The quest to build "national champion" companies, protect domestic markets from foreign infiltrators, conquer foreign markets, be first at commercializing innovation are all central features of Navarro's military/industrial policy ideal.

To Navarro, trade isn't cooperation, but a winner-take-all competition. Trade is a battle between Team America and Team China (or whoever the foreign nemesis may be).

Trade is a zero-sum game, which produces national winners and national losers. There is no room in Navarro's worldview to accommodate the fact that there is no monolithic national interest, but rather a broad diversity of interests that include import-competing and import-dependent producers, service providers, white-collar professionals, manual laborers, consumers and so on, who benefit or suffer the consequences of policies in different ways.

Tariffs on imported Chinese steel, for example, may benefit U.S. steel producers in the short run, but it hurts far more producers in industries that use steel in their own production, and the costs ripple throughout the economy.

The economic illiteracy that animates Navarro's policy prescriptions is startling. In a white paper published before the election describing some of candidate Trump's economic policies, Navarro (and co-author, Wilbur Ross, Commerce Secretary-designate) revealed the central misconception that lies at the core of his global economic worldview.

He wrote: "When net exports are negative, that is, when a country runs a trade deficit by importing more than it exports, this subtracts from growth... The structural problems driving the slow growth in the US economy over the last 15 years have primarily been the investment and net exports drivers in the GDP growth equation."

Of course, Navarro is referring to the national income identity, $Y = C + I + G + X - M$, which accounts for the disposition of GDP.

The accounting identity says that national output is either (C)onsumed by households; consumed by businesses as (I)nvestment; consumed by (G)overnment as public expenditures; or e(X)ported. Those are the only four channels through which national output is disposed.

But the identity is not a GDP growth equation. Imports have nothing to do with GDP – other than the fact that they increase when the economy is growing and they tend to decrease when the economy is contracting.

Then why do we subtract M, which signifies i(M)ports? We subtract M because imports are embedded in the aggregate spending of households, businesses, and governments. If we didn't subtract M, then GDP would be overstated by the value of spending on imports.

But there is no inverse relationship between imports and GDP, as Navarro asserts. In fact, there is a strong positive relationship between changes in the trade deficit and changes in GDP.

The dollars that go abroad to purchase foreign goods and services (imports) and foreign assets (outward investment) are matched almost perfectly by dollars coming back to the United States to purchase U.S. goods and services (exports) and U.S. assets (inward investment).

Any trade deficit (net outflow of dollars) is matched by an investment surplus (net inflow of dollars). That investment inflow undergirds U.S. investment, production, and job creation.

The U.S. balance of payments has shown trade deficits for 41 straight years — a period during which the size of the U.S. economy tripled in real terms, real manufacturing value added quadrupled, and the number of jobs in the economy almost doubled, outpacing growth in the civilian workforce.

Fallacies about imports and the trade deficit, as well as the myth of manufacturing decline, form the basis for Navarro's policy prescriptions, which include subsidizing exports and taxing imports to achieve trade balance.

But trade balance isn't the objective of trade policy; economic growth is. Taxing imports would put the economy on the express lane to recession.

Some in the policy and media world are accepting the lemons and preparing to make trade policy lemonade. Chris Hayes, the host of MSNBC's "All In" show recently tweeted, "I get all of the economic arguments for why a 10% import tariff would be bad. But I'll confess I'm curious to see what would actually happen."

Americans are going to have to be much less cavalier about the direction of public policy in the Trump administration.

On trade, Navarro's voice will be one among many, so it remains uncertain how his dangerous views will hold up among the other less virulent strains of economic nationalism competing for the president's attention.

If one assumes that Trump wants the economy to grow and create jobs, there can be no accommodation of Navarro's crazy scheme to eliminate the trade deficit and achieve "balanced trade," which would cause massive capital flight, closure of foreign markets to U.S. goods, economic meltdown, and – hopefully – open revolt by congressional Republicans to neutralize the Trump presidency.

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