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OPINION | REVIEW & OUTLOOK

How to Think About the Trade Deficit

Peter Navarro is wrong about the U.S. balance of payments.

National Trade Council adviser Peter Navarro, right, and White House Chief of Staff Reince Priebus, center, await President Donald Trump's signing three executive orders, Monday, Jan. 23, 2017, in the Oval Office of the White House in Washington. *PHOTO: EVAN VUCCI/ASSOCIATED PRESS*

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President Trump's chief trade adviser, Peter Navarro, recently argued on these pages that trade deficits are so economically harmful that U.S. policy should seek to eliminate them. This bad idea has been gaining adherents, so perhaps it's time for a tutorial on trade and the wealth of nations.

Americans may be alarmed when they hear that the U.S. buys more from the rest of the world than it sells because they can't run a household deficit. But national accounting isn't the same as household accounting, and a trade deficit isn't a debt that must be repaid. It is often a sign of economic prosperity.

Start by keeping in mind the basic formula embedded into the national balance of payments: A trade deficit equals a capital surplus. The trade deficit is part of the "current account" and it means that

Americans are importing more merchandise and services than they export. On the other side of the ledger is the "capital account," which records capital inflows. When the U.S. has a current-account deficit it has to have a capital-account surplus of the same amount.

This is not by choice or speculation. It happens by definition because for every buyer there must be a seller, as these columns have written for 125 years. The national payments must "balance."

The capital-account surplus arises, in part, because in selling oil, TVs, jewelry, cars, steel and clothing to Americans, foreigners get dollars in return. Mexicans and Chinese could wallpaper their dining rooms with Georges and Benjamins. But it is more common to put the money in dollar-denominated assets like real estate, stocks, debt or dollar bank accounts.

Eliminating a current-account deficit is not as easy as it sounds because it is often the byproduct of a healthy economy. It means the purchasing power of the currency is strong, and consumers are rich and optimistic enough to spend. The opposite is also true: Countries in recession after a devaluation tend to have trade surpluses as the unemployed are forced to tighten their belts and even those working cannot afford imports.

If trade surpluses were a sign of success, the 1930s might have been different in the U.S. As George Mason economist Don Boudreaux points out on his Cafe Hayek blog, "For only 18 of the 120 months of that dreary decade did the United States run a trade deficit. For each of the remaining 102 months of the decade of the 1930s the U.S. ran a trade surplus."

On the other hand, the U.S. ran a trade deficit in nearly every year of its rapidly growing first century and all through the prosperous 1980s and 1990s.

Mr. Navarro understands this enough that he also warns about the capital surplus—to wit, that much of it goes to finance an investment shortfall in the U.S., especially government borrowing. Yet Americans are making millions of individual decisions about how much to save, and foreigners are not forcing Washington to borrow. If government weren't gobbling up that capital, more of it would go into the private economy.

Yet much of this foreign capital does go to finance mortgages and consumer loans, which help the U.S. standard of living. And much is invested in land, plants and equipment and financial assets, none of which needs to be repaid and all of which can make the U.S. economy and exports more globally competitive. If Mr. Trump delivers on his promise to cut taxes, investing in the U.S. will be even more attractive.

The “economic nationalists” fret about foreigners buying U.S. property, but that hardly jeopardizes U.S. sovereignty. The U.S. capital stock isn’t a fixed amount and adding to what is here doesn’t diminish U.S. ownership. It does, however, allow current owners to cash out of their property and put that money to other uses. The owner of a bricks-and-mortar business might sell and invest in a tech start-up. Restricting foreign ownership would reduce demand to hold U.S. assets, hardly a way to make America great again.

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Perhaps the best way to think about the U.S. trade deficit is not to think about it. Way back in 1978 a group of economic eminences tasked with looking at the U.S. balance of payments noted that “the words ‘surplus’ and ‘deficit’ should be avoided insofar as possible.” They added that “these words are frequently taken to mean that the developments are ‘good’ or ‘bad’ respectively,” but “that interpretation is often incorrect.”

An earlier Review Committee for Balance of Payments Statistics in 1965 warned that “No single number can adequately describe the international position of the United States during any given period.” Perhaps it’s time for another such committee to clarify this debate.

Short of that, the Trump Administration should focus on policies that restore the economy to its 3% annual growth historical trend. If growth is fast enough, and incomes are rising, no one will care about the trade deficit.