

Trump's Nutty Professor

Will Trump's economic policies bring prosperity, jobs and joy to the US and the global economy?

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Picture of Peter Navarro from Bloomberg News

Whether Trumponomics becomes a success or a failure depends a lot upon to whom of his economic advisors Mr. Trump listens. His most central advisor, Peter Navarro, is an MIT-educated professor at the highly respectable University of California, Irvine.

The problem is that when it comes to macroeconomics Peter Navarro is ignorant.

Navarro knows that a nation's gross domestic product = consumption + investment + exports – imports. He then reasons that if the US, by protectionist means, increases exports and cuts imports then GDP increases.

But this is a fundamental misunderstanding. The equation above is merely an accounting identity. It tells us nothing about how gross domestic product is determined. As an accounting identity it gives no more information than knowing that on a firm's balance sheet, its equity equals its assets minus its debts.

Theory and experience tell us that imposing protectionism, for example through higher tariffs on imports, causes gross domestic product to decrease - through a multitude of effects. The prices of imported inputs become more expensive, hurting domestic firms. Firms that exports face retaliatory measures. The economy operates less efficiently, as large scale production and specialization are curtailed. Investments are cut, leading to less capital per worker. Less capital means lower wages – or higher unemployment. And equity holders take a hit through lower profits.

So Trumponomics can cause a deep recession in the US and a new global recession.

Let us all hope that Trump's nutty professor, who is going to head a new office in the White House responsible for trade and industry policy, gets a damascene conversion before January 20. Or, that president Trump instead will listen to other, sound, economic advisors – such as Larry Kudlow and Arthur Laffer. Or, that Congress will crush protectionist aspects of Trumponomics. If so, Trumponomics – with an emphasis on deregulation and tax cuts – might spur American and global growth.