Introduction

Some things matter whether or not they exist. The Loch Ness monster is one. National trade deficits are another. Trade deficits obviously matter to many people, because (whatever they are) they seem to have significant consequences. They cause problems or create undesirable constraints or compel government policy changes.

It is often extraordinarily difficult, however, to determine the precise consequences of trade deficits, real or alleged. The current U.S. trade deficit provides a good example. Are the problems supposedly associated with it the causes of the deficit or its effects? Has the United States been running a continual trade deficit since 1975, as some reports would have it? Or are we only on the way toward a deficit, as a consequence of our current economic recovery and the lagging recovery of our principal trading partners?

Both claims are made and published. Those who report to alarmed readers that the United States has run a trade deficit in every single month over the past seven years almost never stop to reconcile this “fact” with the equally well-established “fact” that U.S. exports of goods and services exceeded imports from 1976 through 1982 by an annual average of almost $13 billion.1 How can a $90 billion surplus be accumulated by running deficits each and every month?

The explanation, of course, is that the monthly “deficits” are the difference between merchandise exports and imports, while the annual “surpluses” are the difference between exports and imports of merchandise plus services. Now it is essential that the phrase “of course” appear in the above explanation, to avoid any implication that I think I am saying something new or profound by calling attention to the


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1In this paper all data on U.S. international transactions are based on the standard Department of Commerce calculations, as reported in numerous official publications. See, for example, the International Statistics section in the monthly issues of Economic Indicators.
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difference between the merchandise trade balance and the balance on goods and services. After careful reflection, however, I want to withdraw the phrase. Let the first sentence of this paragraph stand unblushingly stripped of its fig leaf.

It is quite possible that nothing at all in this paper is new or profound. That in fact is exactly how it appears to me. The entire essay seems to me to be a series of fairly obvious assertions. If I am going to start saying "of course," therefore, I will have to do an awful lot of it, and that would quickly grow tiresome. More importantly, it would disguise the essential point I want to make, which is that we are not thinking carefully or communicating responsibly when we talk about trade deficits. I am therefore going to omit the defensive "of course" in everything that follows, and try instead to be clear. It might even happen that, if I make my position unmistakably clear, some critic will be able to rescue me from error, and show me why those who speak of trade deficits are in fact making sense, not wandering in darkness and confusion.

It is not only backwoods editors or small-town journalists who treat deficits in merchandise trade as if they were more than they are. The Wall Street Journal and the New York Times frequently report the Commerce Department's monthly merchandise trade figures in a language of alarm, offering no hint to the reader that the deficits result from a partial accounting. The government's forecast of a more than $100 billion merchandise trade deficit for 1984, for example, was referred to by the Journal as "a red-ink total." If they do these things in a green tree, what shall be done in the dry? So let us return to fundamentals to see if we can first agree what it is we are talking about.

We should all be able to agree that any report of a deficit or surplus in a nation's total international transactions is necessarily based on a partial accounting of some sort, for the simple reason that all international economic transactions are treated as exchanges, in which, for accounting purposes, the value of whatever is given up is exactly equal to the value of what is obtained in return. Consequently, the balance of payments always and necessarily balances. If the flow of measured exports exceeds or falls short of the total of measured imports, measuring errors must have occurred—as they are bound to do in any attempt to keep track of the international transactions of 230 million people. The record keepers consequently add the dif-

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