Myth 6: A trade surplus is good; a deficit is bad.

*The trade deficit does not belong to any individual or institution. It is a pure statistical aggregate, like the number of eggs laid in the U.S. or the number of bald-headed men living here.* —Herbert Stein

The term “trade deficit” is misleading. “Deficit” generally suggests something bad—like excessive spending relative to income or an overdraft at the bank. A *trade deficit occurs when a nation receives more goods and services from foreigners than it supplies to them.* What's bad about that? After all, isn't consumption the ultimate objective of economic activity? Conversely, a trade surplus is present when a nation supplies more goods and services for foreigners to consume than it receives from them. What is so good about that situation? Is this something that people will want to continue to do?

A trade deficit is the flip side of a capital account surplus. With floating exchange rates, market forces will bring the American purchases of goods, services, and assets from foreigners into balance with their sales of these items to foreigners. Thus, a *trade deficit will occur when the U.S. economy is offering investors such attractive options that foreigners are investing more in the United States—buying more assets—than Americans are investing abroad.* Again, it is hard to see what is bad about this situation. Would we prefer that our economy to be in such poor shape that investors—domestic as well as foreign—had better options elsewhere?

Doesn’t a trade deficit mean greater indebtedness to foreigners? Not necessarily. *Much of the foreign investment involves the purchase of stocks and physical assets like buildings and business assets. Americans benefit because they are able to sell these assets to foreigners at more attractive prices than would otherwise be possible.* Foreign investments of this type do not increase American indebtedness to foreigners. Of course, some foreign investments are in the form of loans or the purchase of bonds. These transactions mean lower interest rates for Americans. If the investments are sound, they will generate a future income stream that is more than sufficient to repay the loans. Even in this case, the loans are helpful to the U.S. economy.
Myth 8: If trade with another country is fair, our exports to the country will equal our imports from it.

This statement is totally false. There is no more reason to expect bilateral trade to balance between nations than between individuals. Rather the predictable result is (a) trade deficits (purchases that exceed sales) with trading partners that are low-cost suppliers of goods and services that we import intensely and (b) trade surpluses (sales that exceed purchases) with trading partners that buy a lot of the things we supply at a low cost.

Consider the trade “deficits” and “surpluses” of a doctor who likes to golf. The doctor can be expected to run a trade deficit with sporting goods stores, golf courses, and favorite suppliers of items like lawn care, plumbing, and auto repairs. Why? The doctor is highly likely to purchase these items from others. On the other hand, the doctor can be expected to run trade surpluses with medical insurers, elderly patients, and those with chronic illnesses. These trading partners are major purchasers of the services provided by the doctor. Furthermore, if the doctor has a high rate of saving, the surpluses will substantially exceed the deficits.

The same principles are at work across nations. A country can expect to run sizeable surpluses with trading partners that buy a lot of the things the country exports, while trade deficits will be present with trading partners that are low-cost suppliers of the items imported. Table 2 indicates the nations with which the U.S. ran the largest bilateral trade surpluses and deficits in 1998. The surpluses were largest with Netherlands, Australia, Belgium-Luxembourg, Brazil, and the United Kingdom. Do these bilateral trade surpluses indicate that U.S. treats these countries unfairly? Of course not. The surpluses merely reflect that these countries import goods that American producers supply cheaply. On the other hand, the U.S. ran large bilateral trade deficits with Japan, China, Germany, Canada, and Mexico. Do these countries unfairly discriminate against American goods? The U.S. will tend to run bilateral trade deficits with countries that are low-cost suppliers of goods Americans import intensely. This is the major factor at work here. Interestingly, Canada and Mexico—two countries that are most open to U.S. products—are among the high-deficit countries.

What about the trade deficit with Japan? Among high-income industrial countries, Japan’s trade practices are perhaps the most restrictive. However, this is not the major reason for the U.S. trade deficit with Japan. Japan is a major importer of resources like oil and a major exporter of high-tech manufacturing goods. Americans import a lot of the latter, but they export very little of the former. If the U.S. were a low-cost supplier of energy, its trade balance with Japan would look much different. Major energy exporters—including Indonesia, Oman, Saudi Arabia, and the United Arab Emirates—all run sizeable trade surpluses with Japan. In addition, the Japanese saving rate is high and its investment abroad is large. As we have already noted, an outflow of capital will mean a trade surplus. In contrast, the U.S. has a low rate of saving. This differential saving rate between the two countries also contributes to the U.S.-Japanese bilateral trade deficit.
Myth 5: It is sound policy for a country to support a weak industry with subsidies. A liberal interpretation of "dumping" is necessary to protect domestic industry.

… Similarly, a liberal interpretation of “dumping” in the application of our anti-dumping laws impedes our country’s economic growth. Current law provides relief in the form of anti-dumping duties (tariffs) when a domestic industry is injured as the result of a good being sold in the United States at a price below cost or lower than that found in the domestic market of the exporting firm. However, it is not easy to tell whether dumping laws are, in fact, being violated. The prices charged in the home market generally vary and the cost of the firms charged with dumping are not directly observable. Some express fear that foreign producers might attempt to drive domestic firms from the market and then raise their prices to a high level. This is unlikely to be an effective strategy. After all, the high prices would soon attract competitors, including other foreign suppliers.

When analyzing the merits of anti-dumping restrictions, it is important to keep two points in mind. First, price cutting is an integral part of the competitive process. When demand is weak and inventories are large, firms will often find it in their interest to offer goods at prices below the average total cost of production. Domestic firms are permitted to engage in this practice. Why should foreign firms be prohibited from doing so? Second, the use of anti-dumping laws to reduce the competitiveness of domestic markets is sure to be contagious. As a few industries are protected from the competition of foreign rivals, others will seek similar treatment. Herein lies the real danger. If we are not careful, anti-dumping actions will soon become simply another rather thinly veiled mechanism to stifle competition. Our economy has prospered largely because of our reliance on market allocations and avoidance of this type of favoritism. We must not allow the credibility we have earned to be eroded by shortsighted policies.