The Trade Deficit in Perspective

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The U.S. is the world's largest global trading partner meaning that U.S. consumers buy foreign goods and foreigners buy U.S. goods. In a perfect world, these transactions would amount to zero; purchases equaling sales. But that is not the way trade works. For many years, the U.S. has been importing more goods and services than it has been exporting leading to what is called a trade deficit. Other countries, such as Japan, continually experience trade surpluses by exporting more goods and services than they import. One distortion in analyzing these exchanges is the titles attributed to the transactions. Running a trade deficit sounds like a bad thing for a country while running a trade surplus sounds like a good thing. We do not see it that way.

Countries that run trade deficits, importing goods and services that are lower priced than domestic products, should benefit the consumer. On the other side of the equation, the selling country accepts currency to pay for imports. At the end of the day, the importing country has the goods, and the exporter has the currency. Effectively, the exporting country holds the currency to purchase goods at some time. The country can either exercise that right in the future or just continue to hold the currency in the form of investments in securities or other assets. It can also use that currency to purchase goods and services from other countries, but those transactions do not directly affect the balance of trade of the importing country. Theoretically, the surplus country can hold those cash equivalent securities forever. If that surplus is never used to balance the trade in goods and services, then the importing country producers do not have to manufacture goods to produce a trade balance. When that "call" is made on the importing country, companies are called on to produce goods and services for export, which may not be a bad thing. Jobs are created and incomes rise so restoring a trade balance leaves both the buyers and the sellers better off.

The value of trade is whether it is growing or receding. Global economic output can be enhanced when trade is free and not encumbered by political mandates. Placing restrictions on free trade hurts overall economic growth, not to mention the negative effects on the standards of living of consumers in the affected countries. Limitations such as trade embargoes, tariffs, and other stringent trade restrictions contribute to higher inflation and lower global growth. Politicians opting for higher trade barriers contribute to higher inflation and slower global growth. Such decisions are bound to trigger responses that will make the global trade market more restrictive and more costly. Politicians only have to look back to the disaster of the 1930s to realize that trade barriers are devastating.

From a global perspective, whether there is a trade deficit or surplus on a country-by-country basis is immaterial. The key is recognizing that rising global trade will produce a rising standard of living. On the other hand, falling world trade will make life tougher for all.

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