Trade Deficit Nonsense

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Our balance of trade with Japan is balanced. That's the good news. The bad news is that our intellectual midgets—congressmen—cannot understand that. The best single brief analysis of the issue can be found in an article by John D. Fargo, writing in the October 1991 issue of *Freeman,* a publication of the Foundation for Economic Education headquartered in Irvington, New York.

A trade balance sheet has two accounts: the current account, consisting of goods and services exchanged, and the capital account, consisting of stocks, bonds, and investments. As such, the trade balance sheet must always be balanced. Let's look at it.

Scenario 1: Japan sells us $100 million worth of Hondas. If it bought $100 million worth of rice from us, we'd all agree there would be no trade deficit; the current trade account would be balanced.

Scenario 2: Suppose Japan sold us $100 million worth of Hondas and, instead of buying rice, used the $100 million to build a factory in Kentucky. We'd have a $100 million deficit on current account offset by a $100 million surplus (buying something) on the capital account—a balance. Instead of creating American jobs by buying rice, jobs would be created by the factory in Kentucky.

Scenario 3: The Japanese sell us $100 million worth of Hondas but neither buy rice nor build a factory in Kentucky but instead deposit $100 million in a U.S. bank. Again, we have a $100 million deficit on current account and a $100 million surplus (buying something, in this case a bank account) on the capital account. Instead of creating jobs by buying rice or building a factory, the Japanese create jobs by making money available for loans for Americans to buy homes or American firms to build new plants or invest in new equipment.

Scenario 4: The Japanese sell us $100 million worth of Hondas (current account deficit). They neither buy rice nor build a factory nor deposit it in a U.S. bank but buy something already existing, such as the Rockefeller Center or MGM Studios (capital account surplus). The American who got the $100 million may use it to build a new factory in Kentucky or lend it to people to invest, thereby creating jobs.

Next-to-the-last scenario: Honda sells us $100 million worth of cars (current account deficit) but takes the dollars back to Japan. Dollars cannot be spent in Japan, so what might happen? A British firm may sell the Japanese wool. Instead of being paid in yen, they'd be paid with the $100 million proceeds from the Honda sale. The British firm might use those dollars to purchase U.S. Treasury notes (capital account surplus).

Last scenario: This is the one politicians believe and the one I'd actually like, if true. Honda sells us $100 million worth of cars. It buys nothing, and just for the love of dollars, the Japanese keep them stashed in a national cookie jar. Japanese manufacturers work their fannies off just so Americans can be supplied with all sorts of goodies in exchange for slips of paper manufactured by the U.S. mint. That would be wonderful. We Americans could relax and bask in the sun while the Japanese slave to supply cars, cameras, and all sorts of high-tech goods in exchange for slips of paper sporting pictures of famous U.S. presidents. Sorry, I'm afraid the Japanese are not that stupid.

"OK, Williams," you say, "but I don't like the Japanese buying up America!" The fact is that Britain and the Netherlands have much more invested in our country. What's more, if the Japanese get mad at us, are they going to pick up the Rockefeller Center and take it home with them?