
# The Trade Deficit Is Debt? It Just Ain't So!

BY DONALD J. BOUDREAUX

Writing in the October 4 *New York Times*, Nobel laureate economist Joseph Stiglitz worries about "global imbalances." Stiglitz's concerns are revealed in his opening paragraph: "The International Monetary Fund meeting in Singapore last month came at a time of increasing worry about the sustainability of global financial imbalances: For how long can the global economy endure America's enormous trade deficits—the United States borrows close to $3 billion a day—or China's growing trade surplus of almost $500 million a day?"

Borrowing $3 billion each day means that the United States would annually accumulate debt of approximately $1.1 trillion.

While Stiglitz gives no source for his figure, it's likely an estimate of the sum of Uncle Sam's projected budget deficit for this fiscal year ($290 billion) and the projected 2006 U.S. current-account ("trade") deficit ($864 billion). If so, Stiglitz's claim is misleading on two counts.

First, he double-counts. Whenever a foreigner sells a product to an American and then invests the dollars he earns from this sale in newly issued U.S. Treasury securities, the U.S. current-account deficit increases as does Uncle Sam's indebtedness. But it's not two debts; it's one.

> If we applaud when citizens of Wisconsin save and invest in software firms in California or orange groves in Florida, why should we not be equally pleased when citizens of Shanghai save and invest in these same American firms?

To see why, we first need a brief primer on the meaning of the current account. This account measures the dollar value of goods and services exported and imported during some period (say, a year), along with international flows of interest, dividends, and unilateral transfer payments (such as foreign aid).

We can simplify by ignoring all but exports and imports. If the dollar value of exports during the year exceeds the dollar value of imports, that country runs a current-account surplus. If the dollar value of imports exceeds that of exports, the result is a current-account deficit.

Suppose Americans this year spend $900 billion on imports and sell $200 billion in exports. That means we run a $700 billion current-account deficit; we imported $700 billion more than we exported. But why? Why would foreigners ship us $900 billion worth of things they sweated to produce and demand in return only $200 billion worth of things from us? The answer is that they want to spend the $700 billion on things other than American-made goods and services: American assets. They want to invest it in America.

Like Americans, foreigners can invest their dollars in American corporations or in American real estate, or they can simply hold dollars as cash. They can also *lend* the dollars to Americans. A typical way of doing so is to buy U.S. Treasury Notes from Uncle Sam. These Notes are IOUs the government issues to get money that allows it to spend more than it receives in taxes.

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Now we can see Stiglitz's double-counting.

Suppose that all $290 billion of the debt that Uncle Sam accumulates this year is bought by foreigners. Insofar as they purchase this debt with new earnings from the sale of goods and services to Americans, these purchases increase the U.S. current-account deficit.

But does the additional debt that Americans accumulate this year equal $580 billion—the sum of the $290 billion of additional debt that U.S. taxpayers owe to Uncle Sam's creditors *and* the $290 billion addition to the U.S. current-account deficit? No. Americans are in debt by only (!) an additional $290 billion.

American taxpayers owe an additional $290 billion to Uncle Sam's creditors who, in this example, happen this year all to be foreigners. The fact that this purchase of Uncle Sam's debt by foreigners also is counted as an increase in the U.S. current-account deficit doesn't mean that any debt in addition to Uncle Sam's budget deficit is created.

To add the $290 billion current-account deficit to the $290 billion borrowed is to double-count.

There's a second and more fundamental error—one that exists even if Stiglitz's figure of "close to $3 billion a day" refers only to the projected U.S. current-account deficit for 2006. *The current-account deficit is not synonymous with debt.* If Mr. Sony uses the $2,000 he receives from selling computers to Americans to buy $2,000 worth of equity in Exxon, the U.S. current-account deficit rises by $2,000, but no real indebtedness is created. No American owes Mr. Sony anything.

Confusion is caused by calling "debt" that significant portion of the U.S. current-account deficit that does not entail obligations by Americans to repay money to foreigners. And no such obligations exist for foreign holdings of dollar balances, of American real-estate, or of equity in American corporations. It just ain't so that the so-called trade deficit is debt!

Alas, though, problems with Stiglitz's analysis go further. Also unwarranted is his concern with China's trade surplus.

## Balance of Payments

Understanding why this concern is misplaced takes us to the heart of problems with the so-called "balance of payments." To the extent that people trade across political borders, national economies lose much of their relevance. The relevant economy becomes larger than that of any one country. This development is beneficial, for it means (among other things) that failure to save and invest can be made up by foreigners doing so. Likewise, failure of any one country to provide ample enough investment opportunities for domestic savers can be made up by access to investment opportunities in other countries.

China's average daily trade surplus of $500 million means that the Chinese now annually save about $182.5 billion that they then invest outside of China. Why is that a problem for the United States? If we applaud when citizens of Wisconsin save and invest in software firms in California or orange groves in Florida, why should we not be equally pleased when citizens of Shanghai save and invest in these same American firms?

One response—the only one with any merit—is that much of China's savings is done by the Chinese government, which then invests these savings abroad. Unlike private citizens, governments' motives for saving and investing are influenced heavily by political rather than purely economic considerations. This situation does pose a potential threat, for the Chinese government might for political reasons suddenly dump its holdings of foreign assets and severely disrupt credit markets. But this threat comes from an economically harmful decision the Chinese state might make, not from the mere fact that China now runs a significant trade surplus. It's carelessness, at best, for a Nobel economist to suggest in the *New York Times* that a country's trade surplus is itself a problem for the global economy.

And even the threat posed by large Chinese government holdings of foreign assets isn't great. No credible argument suggests that Beijing is hoarding such assets simply to dump them all at once. Indeed, if a sudden disgorging of assets by Beijing were likely, asset traders would respond today by selling dollars and other non-Chinese assets "short." Such short-selling, however, isn't occurring. Of course, asset traders might be myopic or ill-informed. But for my money, I trust the expressed judgments of private market participants far more than I do those of an academic economist whose reputation is based on his ability to describe all sorts of market failures that, while possible, are rarely plausible.