

# Rear Windows, Trade Deficits

by Robert F. Graboyes  
Federal Reserve Bank of Richmond  
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A neighbor's window seldom reveals enough to solve a murder. And a single economic statistic seldom reveals enough to explain a country's economy.

A single clue is a good place to begin an investigation, rather than to end it. It helps to have many and varied clues.

## The Journalist's Window

In Alfred Hitchcock's 1954 movie, *Rear Window*, L.B. Jeffries (Jimmy Stewart) is a photographer, temporarily in a wheelchair. To combat boredom, he sits at the rear window of his apartment, watching the strangers in the adjacent buildings. He sees a songwriter struggling to compose a melody, a lonely woman who appears to dine with an imaginary guest, a couple lost in the love of newlyweds, a dancer who entertains and then fends off suitors. From brief, intermittent images, Jeffries tries to decipher the stories of these people's lives.

In time, Jeffries focuses his attention on one man. The man's daily routine changes abruptly. He packs a crate. He smokes a cigarette in the dark. A neighbor's dog behaves strangely. Some flowers change inexplicably. These fragmented images suggest to Jeffries that the man has committed a murder. If Jeffries's impression is correct, he must report the crime; but if the impression is erroneous, calling the police will bring a nightmarish accusation down upon an innocent, already-suffering stranger. Jeffries is torn by the knowledge that the windows yield only a partial view—that much of what these people do occurs in the dark, behind closed shades, and in rooms unseen from his window. And what he does see is not always what it seems.

## The Statistician's Desk

We can learn from Jeffries. Consider this newspaper headline: India's Trade Deficit Worse in 1995. The cells in a table of trade data are the windows through which we can glimpse, but only glimpse, the economies of nations. What an isolated number tells us may be far less important than what it does not tell us. Like Jeffries, we risk much if we read too much into a few shards of evidence.

India reported a \$4.8 billion trade deficit in 1995. Consider how some hypothetical observers might react upon reading this figure in the newspaper: Patel (a highly cautious individual) only assumes that the number means what its definition says it does—that in 1995, the goods that India purchased from other countries were worth \$4.8 billion more than the goods that India sold to other countries. Singh (more analytical than Patel) notes that India has long had a trade deficit and laments that the country habitually lives beyond its means. Seth (more accusatory than Singh) complains that India's imports, in effect, send jobs overseas and leave Indians unemployed. Rao (more active politically than Seth) demands that India's government do something to stem this insidious outflow of cash and jobs. Like Jeffries, though, each observer—even the cautious Patel—rests his judgment on a small piece of circumstantial evidence.

Trade data seek to measure the value of goods passing across one country's borders. In 1995, statisticians reported that \$36.0 billion in goods entered India from elsewhere and that \$31.2 billion worth of goods left India for other destinations (hence, the \$4.8 billion deficit). But how did the statisticians gather their information? They did so in the same way that Jeffries gathers his information in *Rear Window*—by piecing together tiny swatches of disparate, incomplete, and sometimes erroneous information.

Even if data collection were perfect, though, we would still be wary of judging an entire economy on the basis of the trade deficit alone. Standing alone, trade data tell us little or nothing about huge parts of the economy—including much of the international sector. Trade data alone don't tell us why there is a deficit—and there are healthy as well as unhealthy reasons for deficits. Here are some specifics on why we ought to look at more than just this one number in isolation:

- In observing one window—the trade deficit—one might miss what happens in other windows. "Trade" commonly refers only to the movement of goods—physical objects—across borders. When a software engineer in New Delhi e-mails his work to a California computer company, the money he earns shows up in an account labeled "services." When an Indian bank receives an interest payment from an English borrower, the proceeds are labeled "income." When an Indian laborer sweats in the oil fields of Saudi Arabia, the paycheck he mails to his family in Hyderabad shows up under "transfers." For India, each of these represents income from overseas, yet none is listed in the "export" figures. (In this case, adding in services, income, and transfers would increase the 1995 deficit to \$5.5 billion, so our observers will be even less pleased than before.)
- Trade accounts represent the movement of goods, and not necessarily change in ownership. If an American firm ships parts to its own factory in India, the trade accounts may record the shipment as an import, though no Indian has bought anything from any American. And, if an Indian firm later purchases the parts from the American firm, this sale may not appear as an import, even though an Indian concern has now bought goods from an American entity.
- Like Jeffries, the statistician does not see all that happens. Conceptually, a traveler who wears a \$5,000 necklace on a flight from India to Hong Kong in 1995 "exports" the necklace just as surely as the American firm above imports the parts for its factory. It is possible, though, that no official will ever know that the necklace has crossed the border. Perhaps the law doesn't require a report; perhaps the person is smuggling; or perhaps the traveler will still be wearing the necklace upon her return to India in 1996. In any of these cases, though, the statisticians fail to note a \$5,000 export in 1995.
- In *Rear Window*, Jeffries sees some occurrences but does not understand their true nature. A British firm may inform Indian customs officials that it is shipping equipment out of India. The British firm may claim the machinery is worth \$8 million when its true value is \$10 million. Perhaps the firm is lying; or it may be that the rules of accounting allow the firm to declare the price it paid for the equipment some years ago, rather than the value of the equipment today. Either way, this undervaluation leads the statisticians to overstate India's trade deficit by \$2 million.

A trade deficit might indicate that a country's citizens are on a spending binge, buying goods to be consumed almost immediately (e.g., luxury foods). Or, a deficit might indicate that citizens are buying inventories and other materials for the businesses in which they are investing. In theory, the trade

accounts ought to include only consumption goods, but in practice, statisticians cannot neatly separate out all investment goods.

Even if further investigation tells us that the trade deficit really does represent consumption (rather than investment) it does not tell us whether such spending is prudent or not. We might note that one of our neighbors has suddenly begun buying expensive cars, paintings, clothes, and wine. If we know the neighbor is still working as a grocery clerk, we may conclude that the spending spree represents a loss of prudence; but if we learn that the neighbor has won the state lottery, then the purchases may seem more sensible. Similarly, nations sometimes "win the lottery" by discovering oil, increasing worker productivity, experiencing windfall gains on investments, and so forth. In such cases, it may or may not be sensible and prudent for the country's citizens to run a trade deficit in response to the change.

Demographics is an important determinant of spending habits. Typically, individuals save for old age when they are young, and then spend their savings when they reach their older years. Age distributions differ across countries; on this basis alone, we might expect a country with an older population to run a trade deficit and a country with a younger population to run a surplus. In this case, the deficit and surplus may only tell us of differences in age, not in prudence or spending habits.

Finally, even if Patel, Singh, and Seth are correct, Rao's call for the government to limit imports may be fruitless. A trade deficit represents the individual purchases of millions of individuals. If a government seeks to limit certain imports, these individuals may respond by importing other goods, working less, failing to build businesses, smuggling more, moving overseas, and employing lawyers and accountants to help them evade the limits. In the end, import restrictions may fail to limit imports while disrupting the economy in other ways.

In the end, Jeffries is led to the truth (which is not revealed here). He could never have learned this truth without his observations at the window, yet he could not have learned the truth with only those observations. Similarly, to understand India's economy, one cannot do without trade data, nor can one do with trade data alone.

In *Rear Window*, L.B. Jeffries was planning a trip to India. Were he to make the journey, he might consider visiting a statistician in the government's trade section. Each could learn from the other.