



National Economic Trends



An Overstated Headline

One economic statistic that makes headlines every month is the trade deficit—the excess of imports over exports (see page 19). As with any other economic statistic, the end product contains errors if the raw data are error-prone. Sometimes the errors tend to offset one another, and sometimes they clearly do not. Merchandise (goods) exports—and therefore the merchandise trade deficit—fall into the latter category.

The Census Bureau, the agency responsible for the trade data, believes that overall merchandise exports are understated for three reasons, with corresponding overstatement of the trade deficit. First, although Census bases merchandise trade figures largely on the paperwork that importers and exporters must file with the U.S. Customs Service, exporters are not required to file paperwork for shipments valued at less than \$2,500. Instead, Census relies on a survey to estimate the fraction of total trade that ends up in these small shipments. This methodology would work reasonably well, except that the most recent survey was conducted almost ten years ago. Changes in the pattern of trade have increased the frequency of small shipments relative to large ones, but the magnitude of this shift is unknown. In particular, the boom in inexpensive air cargo services has made “just-in-time” deliveries of small shipments possible and encouraged smaller firms to enter export markets.

Second, since taxes or tariffs typically do not apply to exports, enforcement of the reporting requirements has been less rigorous than for imports. The incentive this produces is clear: Exporters, particularly those for whom paperwork is more of a burden, will be more likely than importers to ignore the reporting requirements.

Third, our exports are another country’s imports, so U.S. exporters have a direct incentive to undervalue their shipments to circumvent the other country’s tariffs or quotas, especially if the other country’s tariffs are high or enforcement is lax.

Based on fragmentary evidence, Census believes that merchandise exports are probably understated by 3 to 7 percent, but possibly by as much as 10 percent. (The sources of data for services trade are separate surveys, so these particular measurement problems do not arise in estimating service exports.) Since there is no evidence of similar errors in import data, the merchandise trade deficit is more dramatically overstated—possibly by as much as 34 percent in 1997, according to Census.

The effect of export understatement on the merchandise trade deficit is not constant, of course; even if exports were understated by exactly 5 percent in every quarter, a change in either exports or imports would change the fraction of the reported trade deficit due to error. For example, if the *reported* trade deficit equaled 5 percent of exports, the deficit would be entirely due to export understatement.

Applying the principle that import reporting is more consistent, the Census Bureau has already taken a big step toward reducing export understatement. Since January 1990, exports to Canada, our largest trading partner (see page 18), have been based on Canada’s import data. (Canadian exports are now based on U.S. import data.) Before this change, the understatement of exports was worse: It was estimated that our exports to Canada were understated by as much as 20 percent.

In principle, the strategy followed for United States-Canada trade could be applied to exports to other countries, but it requires detailed harmonization of reporting requirements, and therefore is not practical in the short run. Instead, Census and Customs are concentrating on encouraging electronic reporting and improving compliance with export reporting requirements.

—Joseph A. Ritter