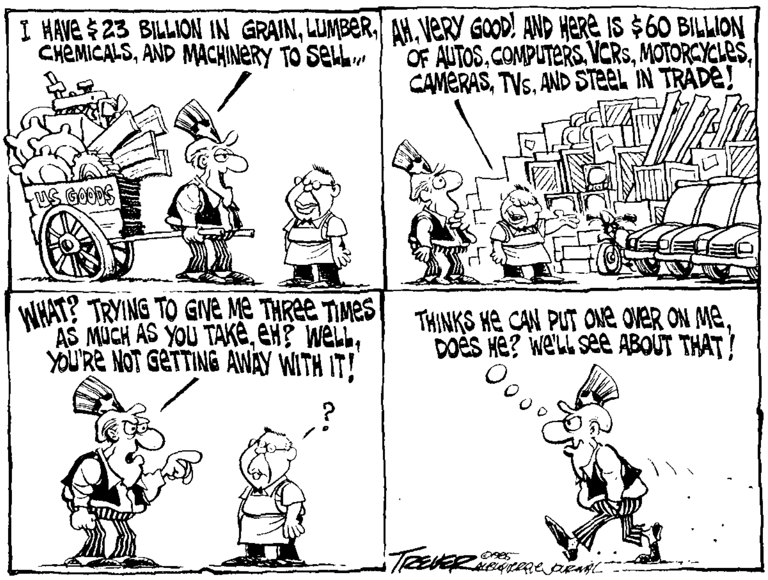
viewpoint

By Scott C. Matthew

Three Cheers for Trade Deficits

It's aggravating to watch government and private economic "experts" confusing and distorting the general perception of the US balance-of-trade deficit. Most of what we hear coming out of Washington on the subject is self-serving nonsense—doomful pronouncements to scare up support for policies protecting special-interest groups.

Simply put, in 1984 the rest of the world sent the people of the United States roughly $452 billion worth of goods and services. At the same time, the rest of the world accepted roughly $362 billion worth of goods and services from the United States. The $90-billion difference is the US trade deficit. (Those wishing to distort the picture will often quote a higher figure that ignores the US surplus in services exported.)



If we paid the world $90 billion more than it chose to spend on US goods and services, what did they do with the money? Nothing terribly dangerous or insidious. In fact, they made a net investment of about $60 billion in our economy and chose to hang onto about $30 billion worth of those little pieces of paper called dollars. What do the experts think the problem is? Good question!

First, let's consider the major portion of that deficit—the $60 billion that foreigners invested in the United States. Politicians and special-interest groups are screaming that we must force the rest of the world to spend that $60 billion on goods and services *today*, rather than allow them to spend it on stocks and bonds. They claim that we would be much better off if we could just get our trade partners to cart $60 billion worth of goods back home. The special interests warn that if the appropriate measures are not taken soon, economic hell will break loose. This view is nonsense.

Americans, of all people, should understand that well-conceived investments benefit *everyone* involved. The investor supplies capital to a given project because he believes it shows the best potential for return. The person accepting that investment does so because he believes that he can produce the proper return for the investor using that capital and still have wealth left over for himself. If the investor simply holds onto his wealth, he misses the opportunity to make more. And if America refuses that investment, it misses the opportunity to increase its wealth as a nation.

When foreign investors give us $60 billion to work with, they are giving us the chance to produce wealth for ourselves by using their wealth. They are building factories, doing research, creating jobs here in America. In an uncertain world, we all like to have a little something saved for a rainy day. The rest of the world understands that there is no safer place to set aside that emergency fund than in America. Rather than consume all their wealth today by buying goods from us, foreigners choose to invest some of that wealth in America. And investing in America is good for everyone—especially Americans.

What about that other $30 billion that foreigners simply hung on to in 1984? That was a gift presented by the world to the United States. Americans sent $30 billion worth of little pieces of paper out for goods. The rest of the world chose to hang on to the dollars themselves rather than cash those dollars in for real things. For much of the world, the US dollar has taken on the role traditionally played by gold—it is a store of value and medium of exchange in troubled times, a parallel currency that fuels what little life some economies have. That others in the world will give up real things just for a sense of sharing our security is a vivid testament to the relative strength and stability of the American economy.

So the situation is really quite simple. Having traded wealth for wealth with us, foreigners may either take all their wealth home with them to consume, or they may leave some of it here in America to produce more wealth—both for its foreign owners and for Americans. Now if Congress passes legislation forcing the people of other nations to take all their wealth home with them, a few special-interest groups stand to benefit. But if that wealth remains here in America, producing still more, then the nation as a whole will benefit. We couldn't even begin to force the world to spend the billions of our paper dollars it hoards, and we would be foolish to try to force foreigners to invest their wealth elsewhere.

To argue that foreign imports are hurting America is to miss this fundamental point: if both parties in trade didn't perceive benefits for themselves, there would be no trade. Those who still insist that it is in America's best interest to force other nations to drag their wealth home with them after the trade, rather than to let them leave some of it here to grow, are talking about *their* special interest, not America's interest.

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By Timothy Condon

You Can Still Squeeze Through Loopholes

As I write this, the big news is "tax reform." As you read this, the big news will doubtless still be "tax reform."

Traditionally a polite way of referring to "tax increases," this time it may actually *mean* something. Even under the much-ballyhooed "Treasury II" plan that President Reagan has pushed—clearly the least attractive among the three main contenders, which include the Democrats' Bradley-Gephardt bill and the excellent Kemp-Kasten proposal—there will be some relief, for some people. The most attractive feature of all the bills is the simplification and "flattening" of tax rates, bringing the all-important marginal tax rate (the highest rate paid for the last dollar you earn during the year) down from an obscenely high 50 percent to 25 percent or 30 or 35 percent, depending on whose proposal you're looking at.

So relax, man, sit back and enjoy the new breaks, relax on the tax, you know? Well, no, not really. You see, in all the proposed tax plans there are "losers," foremost among them people like myself, who take advantage of every nook and cranny in the tax code. It's still a good idea for all Americans, as a patriotic duty, to try and minimize their taxes to the max.

So what to do? A good first step would be to buy a copy of the new tax act when it gets passed (as it almost assuredly will this year, despite all the professional naysayers hoping for the worst), or at least a popular explanation of the beast. Familiarize yourself with the *new* nooks and crannies, the *new* angles to play...because the new tax plan, no matter what you're hearing from the media, is going to be chockablock with ways to reduce your taxes.

Accordingly—and as I've always preached—the best way to make sure the government doesn't steal an unnecessarily large amount from you is to make sure you know enough about the new tax law to *take advantage of it*. Simple, hah? Here are some areas you should be forewarned to look at closely:

Brackets. First off, you've got to remember that everything you're hearing about "flat-tax proposals" is a lie. *No one* is proposing a flat tax. All the plans simply replace the present 14 or 15 tax brackets with 3 or 4. But the basic rule of so-called progressive taxation still holds: *if you can lower your taxable income, you may shift yourself into a lower bracket where the government won't steal as large a percentage from you.* Under the Treasury II plan, that means you might be able to shift yourself out of the top bracket of 35 percent down to the 25 percent or even (hurrah!) the 15 percent bracket. That's a 10-percentage-point hit prevented with each step. If you know how to exploit the new tax code, you too can pay less taxes by dropping your bracket.

> *The tax plan is going to be chockablock with ways to reduce your taxes.*

Retirement planning. What are the new provisions—expanded IRAs, perhaps, so a nonworking spouse can put in the full amount? Keogh plans for the self-employed made more attractive? Take advantage of all of them: you're not going to be 35 forever, and you'll be making a *hell*uva lot less money—and therefore paying lower tax rates—in 20 or 30 years, when you have to pay the piper for those retirement funds.

Itemized deductions. What about the old Schedule A? It seems a pretty sure bet that the deduction of state and local taxes will be knocked out (a positive development, in my estimation, since big-taxing state officials will be held more accountable by their constituents).

What about medical deductions on Schedule A? Something will doubtless be left, although how much and how helpful is up for grabs. It seems sure that the deduction of home mortgage interest won't be touched, and probably $5,000 or so of other interest will be deductible. Maybe now you should invest in the largest house you can afford. And maybe you should watch your other indebtedness so as to have the maximum interest deduction allowable, but not one cent more. Work expenses of various kinds will probably still be in the picture. You should know what they are. And keep your eye out for casualty and theft loss deductions, which may be retained in a minor way.

Real estate. Take a close look at how investments in this area are affected. Chances are that real estate will continue to be the working stiff's best bet for small-time tax sheltering. Depreciation schedules are doubtless going to be reworked, probably to our detriment; but the shelter will still be there. And all expenses of having a rental property of some kind will most likely still be deductible. You owe it to yourself to know something about it.

Capital gains. Remember that capital gains (that is, profits on the sale of property, machinery or equipment, stocks and bonds, gold, jewelry, etc.) has always been a good way to do well by yourself while avoiding a big tax bite. It will continue to be so, and it even gets a slight (2.5 percent) additional break under the Reagan tax plan.

Family fun. Since everyone seems to be jumping on Reagan's "family-oriented" tax bandwagon, consider falling in love, getting married, and having children. No joke. The new tax code may actually make it worthwhile for good friends, who otherwise prefer to remain single, to get married in order to save cash. Shades of the people who used to get *divorced* every year to save taxes, as a result of the *anti*-family tax laws!

Of course, the "basic" advice given above is the most important: if you don't know what's *in* the new tax law, you can't adjust your actions to effectively save yourself money. If you *do* take the time and effort to educate yourself, then everyone benefits. After all, withholding tax dollars from government never hurt anyone.

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