Balance of Trade

BY JESSIE ROMERO

According to the Commerce Department, U.S. exports reached $185 billion in June alone, near an all-time high set in March. Yet the country’s overall balance of trade was a negative $43 billion, as U.S. imports reached $228 billion.

The balance of trade is the difference between a country’s exports and imports. Exports are domestically produced goods and services sold abroad; imports are the purchase of foreign goods and services. Between 1960 and 1975, the United States ran a trade surplus. Since then, however, the country has run large annual trade deficits, peaking at $753 billion — 5.6 percent of GDP — in 2006. Falling imports brought the deficit to a nine-year low of $381 billion during the 2007-09 recession, but the gap widened to $560 billion in 2011. Rising oil prices added about $100 billion to the 2011 deficit.

How can a country buy more goods than it sells? It borrows from the rest of the world. In the United States, the balance of trade makes up the majority of the current account, which is part of the country’s international balance of payments. The current account is the difference between income and expenditures, which, in addition to net exports, includes interest earned on foreign investments, debt payments to foreign investors, and net unilateral transfers, such as foreign aid. When the income from selling U.S. goods is insufficient to purchase foreign goods, households, firms, and governments borrow on international capital markets. The current account deficit thus reflects net foreign borrowing, and is closely linked to the imbalance in U.S. trade.

The current account balance corresponds to the difference between domestic saving and investment. Because the U.S. saving rate is well below the investment rate, the country relies on foreign capital to finance its investment. That occurs when the rest of the world sends goods to the United States in exchange for what is in effect a financial promise that the United States will send back more goods in the future. Cash is one kind of promise, but since dollars don’t pay interest, other countries use those dollars to purchase assets such as U.S. government bonds, stocks, or real estate. A trade deficit is thus associated with a net flow of financial assets in the opposite direction, and is equivalent to having foreigners finance domestic investment.

The balance of trade is affected by both international and domestic events. One possible explanation for the run-up in the U.S. deficit during the 2000s is the “global saving glut,” a phrase coined by then-Fed governor Ben Bernanke in 2005. In response to a series of financial crises in the 1990s, many developing countries became net exporters rather than net importers of financial capital. Rising productivity and a history of financial and political stability made the United States an attractive home for these investments, leading to higher equity prices and a stronger dollar. Stock market wealth made U.S. consumers more willing to buy goods and services, and the strong dollar made U.S. imports relatively cheap and exports relatively expensive — contributing to a larger trade imbalance.

Some observers attribute the trade deficit to the large decline in manufacturing employment over the past several decades and to the slow job growth coming out of the recession. But running a trade deficit isn’t necessarily a bad thing. Intertemporal trade — that is, importing today and exporting tomorrow — allows a country to smooth its consumption through economic ups and downs. From the perspective of the current account, if a country has a lot of productive investments to make or expects to grow very rapidly in the future, it makes sense to run a current account deficit in the present and pay it back with future surpluses. Moreover, trade deficits often are a result of worldwide production being shifted to its most productive locations.

Although the recession temporarily slowed the growth of the trade and current account deficits, concerns remain about when and how the trade imbalance will be resolved. Some economists fear the United States’ foreign debt is approaching the level where foreign investors would lend money only at much worse terms than at present. Others believe that would be unlikely due to the size, diversity, and resilience of the U.S. economy. Given that yields on U.S. government bonds have actually fallen throughout the financial turmoil of the past several years, it seems unlikely that foreign investors are close to losing faith in the U.S. economy. If the trade deficit rises toward prerecession levels, however, policymakers will be watching closely — but what they should do in response is not so clear. Attempting to narrow the trade gap through import restrictions, for instance, would likely hurt domestic consumers, provoke a backlash abroad, and lower global economic productivity. Such a “cure” could be worse than the perceived problem.