



PLUMBING AMERICA'S BALANCE OF TRADE

The US trade deficit has once again taken center stage as a trade-skeptical Trump administration pursues its agenda in Washington, DC. If policymakers lack a sound understanding of US trade, they risk inflicting unintended damage on the US economy.

In “[Plumbing America’s Balance of Trade](#),” Daniel Griswold, codirector of the Mercatus Center’s Program on the American Economy and Globalization, explains how America’s trade with the rest of the world is always balanced when investment flows are considered in addition to the exchange of goods and services. Using the metaphor of a plumbing system, Griswold explains how trade benefits Americans through imports, exports, and investment by increasing opportunities, creating jobs, lowering prices, increasing the variety of goods, and lowering the cost of borrowing.

SUMMARY

America’s trade and capital flows can be imagined as dollars flowing through a system of pipes that connect the country to the global economy. **In this system, an outflow of dollars from the United States is always offset by an equal inflow of dollars from the rest of the world.**

- One major set of pipes is the current account, which carries the dollars for all transactions for goods and services. While the United States has a trade deficit in goods, it currently has a trade surplus in services.
- Another set of pipes accommodates the enormous flows of capital moving across international borders. The United States benefits from a large surplus in this area. For example, foreign purchasers of US bonds lower long-term US interest rates to the point where a homeowner with a 30-year, \$250,000 mortgage saves an estimated \$115 a month.
- Outflows of capital are beneficial as well. For aging baby boomers building retirement savings, the ability to invest in foreign equities offers more diversification, delivering higher potential returns with lower overall risk.

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- Foreign direct investment—foreign investors’ ownership of controlling stakes in domestic affiliates—also provides immense benefits in the United States. US affiliates that are majority foreign owned employed 6.4 million US workers in 2014.
- Foreign direct investment outflows are often seen as “outsourcing” operations abroad to export products back to the United States, but this is a misconception: of the more than \$4 trillion in products that the US-owned affiliates supplied in 2014, 92 percent were sold outside the United States. These sales generate profits and support employment at the parent companies in the United States.

Foreigners who sell America goods will either spend the dollars they earn on US exports or assets or exchange the dollars with someone else who wants to buy US exports or assets. **Thus, America’s international accounts are always balanced.**

- The United States runs a deficit in trade and a surplus in investment and lending, meaning that foreign investors step in to make up for the shortfall in domestic savings. As long as domestic savings lag behind investment, foreign investors will make up the difference.
- Deficits with a single country are meaningless. Just as individuals have “trade deficits” with their grocery store, so do nations run deficits and surpluses unevenly with one another, and it is impossible to eliminate these deficits without addressing the gap between domestic savings and investment.

CONCLUSION

America’s commercial trade with the rest of the world is a part of a complex, interrelated system. If the US government intervenes by turning the spigot to change the flow of dollars through one set of pipes, it will of necessity change the flow through other pipes. It is a contradiction to decry the outflow of dollars to buy imports while at the same time seeking to increase sales of US exports or investment in the US economy.

Instead of focusing on only one section of America’s balance of payments account, US policymakers should pursue policies that allow Americans greater freedom to buy and sell goods, services, and assets in the global marketplace.