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The U.S. Trade Deficit: An Overview

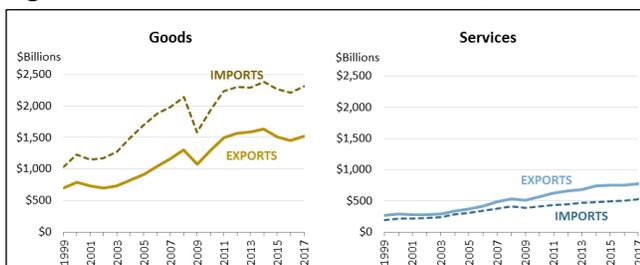
Overview

The trade deficit is the numerical difference between a country's exports and imports of goods and services. The United States has experienced annual trade deficits during most of the post-WWII period. Some observers argue that the trade deficit costs U.S. jobs, is unsustainable, or reflects unfair trade practices by foreign competitors. Most economists contend this mischaracterizes the nature of the trade deficit and the role of trade in the economy. In general, most economists conclude the trade deficit stems largely from U.S. macroeconomic policies and an imbalance between saving and investment in the economy. Economists also conclude that trade creates both economic benefits and costs, but that the long-run net effect on the economy as a whole is positive. At the same time, some workers and firms may experience a disproportionate share of short-term adjustment costs. On March 31, 2017, President Trump issued an Executive Order directing key agencies to prepare a written report within 90 days (not yet published) on significant trade deficits with U.S. trading partners, including a focus on: unfair trade practices; and the impact of the trade deficit on U.S. production, employment, wages, and national security.

What is the Trade Deficit?

The U.S. merchandise trade deficit is an accounting of the net balance of exports and imports of goods, one component of the overall balance of payments. A broader measure of U.S. global economic engagement, the current account, includes trade in goods, services and some income flows. In 2017, U.S. merchandise exports were about \$1.6 trillion; imports were \$2.4 trillion; and the merchandise trade deficit was \$811 billion on a balance of payments basis, with a services surplus of \$242 billion. Exports account for about 12% of U.S. GDP; imports account for about 15%. As indicated in **Figure 1**, the United States annually experiences a deficit in goods trade, but a surplus in services trade.

Figure 1. U.S. Goods and Services Trade, 1999-2017



Source: Bureau of the Census.

By standard convention, each transaction in the balance of payments has a corresponding and offsetting transaction: a surplus or deficit in the merchandise trade account is offset by a transaction in the financial accounts. In these accounts, exports are recorded as a positive amount, because they

represent a credit, while imports are recorded as a negative amount, because they represent a debt that must be repaid.

What is the Source of the Trade Deficit?

Given the composition of the U.S. economy, most economists argue the U.S. trade deficit is the product of U.S. macroeconomic policy. Currently, the demand for capital in the U.S. economy outstrips the amount of gross savings supplied by households, firms, and the government sector (a savings-investment imbalance), which pushes up domestic interest rates. With floating exchange rates and liberalized capital flows, capital inflows bridge the gap between domestic sources of capital and demand, allowing the country to consume more than it produces, represented by the trade deficit. Foreign investors also seek dollar-denominated assets as safe-haven assets during times of economic stress. The dollar, as a de facto global reserve currency, facilitates the trade deficit by broadening the availability of dollars and dollar-denominated assets. Without this unique role, the United States would have faced major challenges sustaining trade deficits without making domestic economic adjustments.

Foreign demand for dollars and dollar-denominated assets places upward pressure on the exchange value of the dollar, which raises the cost of U.S. exports and reduces the cost of imports. As a result, the trade deficit is the offsetting amount of the capital inflows. Economists argue that attempting to reduce the trade deficit without addressing the underlying macroeconomic imbalances could affect the economy negatively in various ways, including but not limited to, reducing the annual rate of growth of the economy and the rate of productivity. Furthermore, most economists argue that domestic wage rates, the rate of unemployment, and the overall rate of growth in the economy are the product of the macroeconomic policy environment rather than the product of trade generally or the trade deficit.

Trade Agreements and the Trade Deficit

Some analysts argue that free trade agreements (FTAs) have contributed to rising trade deficits with some trade partners. The Trump Administration has indicated that its first priority in trade relations is lowering or eliminating bilateral trade deficits. In 2016, the United States ran a merchandise trade deficit of \$71.0 billion with its 20 FTA partner countries, but a services surplus of around \$80.0 billion, or a combined goods and services surplus of about \$9.0 billion. Most economists contend that FTAs are likely to affect the composition of trade among trade partners, but have little impact on the overall size of the trade deficit, given the macroeconomic origins of the trade deficit and other factors. Bilateral trade balances can provide a quick snapshot of the U.S. trade relationship with a particular country, but most economists argue that such balances are incomplete measures of the comprehensive nature of the

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scope of economic engagement between the United States and its trading partners.

Trade agreements generally aim to remove trade barriers and determine the rules by which nations conduct trade. They provide incentives to consumers in the form of lower tariff rates and to firms in the form of lower trade barriers, but behavioral characteristics of consumers and firms determine how those incentives affect bilateral trade. Also, bilateral trade balances are influenced by various and diverse economic policies and activities among trading partners, including: the overall level of economic development, the abundance of raw materials, relative rates of economic growth, formal and informal barriers, and rates of technological change. Also, the growth of cross-border trade through complex value chains and intra-firm trade challenge traditional concepts of trade and trade balances. The U.S. International Trade Commission estimated that in 2012 U.S. bilateral and regional trade agreements increased bilateral trade with partner countries by 26.3%, U.S. aggregate trade by about 3%, and U.S. real GDP and U.S. employment by less than 1%.

A broad range of events, such as the 2008-2009 financial crisis, can affect national economies and trade balances overall to a greater degree than even the most robust trade agreement. As a result, most economists question the usefulness of using bilateral trade balances as indicators of trade relations, the effectiveness of a trade agreement, or the costs and benefits of a trade agreement. With or without a formal trade agreement, trade with specific countries may have a concentrated impact on certain sectors of the economy and entail certain adjustment costs, including changes in employment. These potential costs can be highly concentrated, with some workers, firms, and communities affected disproportionately. In a dynamic economy such as the United States, adjustments are constantly taking place and can occur even in the complete absence of trade.

Trade Deficit and Unemployment

Some analysts argue that the trade deficit equates to a net loss of jobs in the economy by implying that domestic production could be substituted for imports, which potentially could boost both production and jobs in the U.S. economy. As the U.S. economy approaches full employment, however, such an increase likely would lead to rising prices. Most economists argue that equating a trade deficit, whether on a bilateral basis or overall, with unemployment or job losses is questionable given the macroeconomic origin of the trade deficit and the relatively limited role that trade plays in the overall U.S. economy. The International Trade Administration (ITA) estimated that in 2016, U.S. exports of goods and services supported 11.7 million U.S. jobs, or 8% of the U.S. workforce.

In some cases, various groups have used the ITA estimates on jobs supported by exports to argue that if a certain number of jobs were supported by \$1 billion of exports, then that same number could be used to argue that a certain number of jobs would be “lost” by \$1 billion of imports, represented by the trade deficit. As a result, any net increase in imports with FTA countries would necessarily result in a loss of employment for the economy.

While some imports and exports are substitutable, other imports represent items that are not available or are more costly to produce domestically. Also, demands on labor and capital markets vary substantially between export and import sectors. While some job losses associated with imports can be highly concentrated, imports also support a broad range of widely-dispersed service-sector jobs, including transportation, sales, finance, marketing, insurance, legal, and accounting.

Some observers argue that trade deficits tend to reduce the number of jobs and increase the unemployment rate for the economy as a whole. International competition through trade is one of a number of factors that affect the overall composition of employment in the economy and may result in job gains and losses. In general, the unemployment rate and the trade deficit are related indirectly through the rate of growth of the economy. In 2009, in the midst of the global financial crisis, the U.S. rate of economic growth fell to a negative 3.0%, the rate of unemployment rose to 9.9%, and the U.S. merchandise trade deficit declined to -\$510 billion as global trade and global economic activity contracted sharply. In 2006, the U.S. unemployment rate fell to about 4.0%, while the economy grew at an annual rate of 2.7%, and it experienced a merchandise trade deficit of over -\$800 billion. In 2016 and 2017, the U.S. rate of unemployment hovered around 4.0%, while the merchandise trade deficit fluctuated around -\$750 billion.

Issues for Congress

The U.S. trade deficit raises a number of questions for Congress, including:

- If the trade deficit is the result of U.S. macroeconomic policies, as is generally accepted, what is the best approach to reduce that deficit?
- How much importance should Congress give to lowering the trade deficit relative to competing policy goals?
- What is the impact of foreign trade barriers and unfair trade practices on the trade deficit?
- What role does the trade deficit play relative to other domestic factors in determining wages and employment in the economy?

More Information

CRS In Focus IF10161, *International Trade Agreements and Job Estimates*, and CRS Report R44044, *U.S. Trade with Free Trade Agreement (FTA) Partners*, and CRS Report R45243, *Trade Deficits and U.S. Trade Policy*.

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