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Cornhusker Economics

Trade Balances

Market Report	Year Ago	4 Wks Ago	7/14/17
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	117.00	135.06	120.00
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	162.07	187.68	182.33
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	153.02	*	165.82
Choice Boxed Beef, 600-750 lb. Carcass.	206.00	250.22	212.93
Western Corn Belt Base Hog Price Carcass, Negotiated	72.99	78.72	86.31
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	89.41	91.04	104.10
Slaughter Lambs, wooled and shorn, 135-165 lb. National.	161.90	182.77	185.51
National Carcass Lamb Cutout FOB.	342.44	422.54	429.14
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	3.09	3.28	4.04
Corn, No. 2, Yellow **Columbus**, bu.	3.21	3.43	3.38
Soybeans, No. 1, Yellow **Columbus,** bu.	1.012	8.48	9.07
Grain Sorghum, No.2, Yellow Dorchester, cwt.	5.04	5.81	5.71
Oats, No. 2, Heavy Minneapolis, Mn, bu.	2.69	2.89	3.19
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	165.00	*	148.00
Alfalfa, Large Rounds, Good Platte Valley, ton.	75.00	70.00	75.00
Grass Hay, Large Rounds, Good Nebraska, ton.	80.00	*	*
Dried Distillers Grains, 10% Moisture Nebraska Average.	127.50	101.00	102.50
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	37.50	39.50	42.00
***No Market**			

The fact that the United States has a global trade deficit as well as bilateral trade deficits with particular countries, such as China or Germany, has recently received extensive commentary in the news (see Irwin 2016, Constable 2017, Goodman 2017). The balance of trade is the difference between the value of a country's imports of goods and services and the value of its exports and can be either negative (deficit) or positive (surplus). Trade balances between two countries are actually of little economic interest as countries always have trade surpluses with some countries while having trade deficits with others. The overall trade balance will be equal to the summation of these bilateral balances.

Bilateral merchandise (goods) trade balances in 2016 for the United States and 18 of its primary trading partners are shown in Table 1. While most of these bilateral balances are negative, the United States recorded significant trade surpluses with countries such as the Netherlands, Hong Kong and Belgium. Almost half the overall merchandise trade deficit in 2016 was accounted for by trade with China. Merchandise trade is only part of the story, however, as there is growing trade in services and the United States consistently has a surplus in its services trade (Table 2).

Much of the commentary on the U.S. trade deficit is based on the belief that trade deficits are bad, while trade surpluses are good. The idea that a country should run a trade surplus with individual countries or with the rest of the world collectively is derived from an old doctrine known as mercantilism. According to this doctrine, countries should work to limit imports and expand exports so as to generate an inflow of gold and foreign currencies (known collectively as *foreign exchange*). Because it would be impossible for all countries to have trade surpluses, this doctrine sets trade up to be a kind of warfare as everyone tries to sell more abroad while limiting expenditures on foreign goods. Theoretical and empirical economic analyses show that warfare is an inappropriate metaphor for trade which almost always generates mutually beneficial gains. Early classical economists such as Adam Smith and David Ricardo demonstrated that mercantilism is economically incoherent over 200 years ago but mercantilist attitudes persist as evidenced by the current debates about the U.S. trade deficit. It should be noted that foreign exchange can only be used for one thing: to buy foreign articles, that is, to import goods, services, or foreign assets.

Those who worry about trade deficits appear to believe that they have a negative effect on the national economy. We calculated correlation coefficients between the real U.S. trade balance and the unemployment rate, the size of the real GDP, and economic growth over the period 1960 to 2015 and found no significant correlations. Trade deficits result from a complex set of economic forces including domestic savings and investment and both foreign and domestic economic policies. The balance of payments accounts show the overall economic situation of a country with respect to the rest of the world. In addition to exports and imports of goods and services, the balance of payments includes net income from foreign sources and financial flows made up of direct and portfolio (stock market) investments and other financial flows. As shown in Table 2, the large U.S. trade deficit is mostly offset by financial inflows while the large Chinese and German trade surpluses are offset by negative financial flows. Negative overall balances are financed by drawing down foreign exchange reserves, while surpluses add to the reserve holdings. The figures shown in Table 2 reflect abridged versions of the balance of payments that exclude certain details for expository simplicity. The true overall balances in the three countries differ slightly from the figures in Table 2 because of errors and omissions. In 2016, the United States actually added about $2 billion to its reserve holdings.

Because U.S. savings rates are too low to cover desired investment levels, financial flows from foreign firms and individuals are attracted to the large, stable U.S. financial markets (Griswold 1998, Schmidt 2017). In a sense, the United States is able to consume more than it produces and the difference is financed by the rest of the world. For foreign countries, financial investments in the United States not only generate economic returns but they help to recycle the dollars earned through international trade. If Chinese and German foreign exchange holdings were not invested in the United States and other countries, their currencies would appreciate making their industries less competitive internationally.

There are other factors that influence the international economic position of the United States. The dollar is the primary reserve currency used in many transactions carried out by other countries that do not involve the United States. It is advantageous that the United States runs trade deficits because that helps insure that there will be sufficient international liquidity to finance global trade. The United States derives some benefits from these arrangements as well because they give the U.S. government significant leverage in its foreign relations. Because so many international economic transactions are carried out in dollars, it is easier for the U.S. government to apply effective economic sanctions on countries such as Russia or Iran.

As noted by Griswold (1998), trade deficits in the United States "are not a sign of unfair trade practices or a lack of American competitiveness." In some low-income countries trade imbalances have led to significant balance of payments deficits and large outflows of foreign exchange, which may force the country to devalue its currency and/or pursue austerity policies (government spending cuts, tax increases, higher interest rates) if its foreign reserves are depleted. The United States has increased its foreign exchange holdings in six of the past nine years and is in no danger of exhausting its reserves. The bottom line is that when the United States has a trade deficit, it is exchanging domestically-produced goods and services that have a lower total value for foreign goods and services that have a greater total value, which seems like a pretty good deal.

Table 1: U.S. Bilateral Trade with Major Trading Partners, $ billion (2016).

Country:	**U.S. Exports to:**	**U.S. Imports from:**	**Bilateral trade balance**
Canada	266.8	278.1	-11.3
Mexico	231.0	294.2	-63.2
China	115.8	468.8	-347.0
Japan	63.3	132.2	-68.9
UK	55.4	54.3	1.1
Germany	49.4	114.2	-64.9
Korea	42.3	69.9	-27.7
Netherlands	40.4	16.2	24.2
Hong Kong	34.9	7.4	27.5
Belgium	32.3	17.0	15.3
France	30.9	46.8	-15.8
Brazil	30.3	26.2	4.1
Singapore	26.9	17.8	9.1
Taiwan	26.0	39.3	-13.3
Switzerland	22.7	36.4	-13.7
UAE	22.4	3.4	19.0
Australia	22.2	9.5	12.7
India	21.7	46.0	-24.3
Total, countries listed	1,134.7	1,671.7	-537.0
Countries listed, % of world total	78.0%	76.4%	73.1%
World total	1,454.6	2,188.9	-734.3

Source: U.S. Census Bureau(https://www.census.gov/foreign-trade/balance/index.html)

Table 2: Simplified Balance of Payments Accounts, USA, China and Germany, $ billion (2016)

	United States	China	Germany
Merchandise trade balance	-749.9*	494.1	300.8
Service trade balance	249.4	-244.2	-24.9
Income balance	19.4	-53.5	13.1
A. Current Account Balance	-465.5	196.4	289.0
Net direct foreign investment	77.8	-46.6	-23.8
Net portfolio investment	250.2	-62.2	-165.8
Other financial flows (net)	80.4	-308.2	-67.8
B. Financial Account Balance	408.4	-417.0	-257.4
Overall Balance of Payments (A + B)	-72.7	-220.6	31.6

Source: IMF (http://data.imf.org/regular.aspx?key=61468205)
*This figure comes from a different source than was used for Table 1 and differs slightly from the value in that table.

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