CATO
POLICY ANALYSIS

November 9, 2023 Number 964

Trade and Investment Are Not a Balancing Act

By Norbert J. Michel

EXECUTIVE SUMMARY

The trade deficit is the amount by which the value of a country's imports exceeds the value of its exports during a given period, such as one calendar year or quarter. It is a commonly misunderstood concept that inspires harmful economic policies, such as proposals that a country "balance" its imports and exports by taxing international capital flows. Supporters of this policy hope to shrink the trade deficit (i.e., to balance imports and exports) by taxing the capital surplus that goes along with a trade deficit in the balance-of-payments framework. In the United States, senators Tammy Baldwin (D-WI) and Josh Hawley (R-MO) authored a 2019 bill to do this and, though it died in the Senate Banking Committee, similar legislation may appear in the future.

This kind of policy is highly flawed on theoretical, empirical, and practical grounds. For starters, trade deficits and capital surpluses are merely part of a national accounting system that includes multiple arbitrarily assigned categories. In fact, even the concept of balancing in the national accounting system is not as straightforward as supporters of balancing trade flows suggest. The evidence demonstrates that there is no clear negative relationship between a trade imbalance and a country's optimal economic performance, especially regarding employment in manufacturing, which is a common concern among politicians. At best, taxing international capital flows would fail to change the incentives that drive US consumers' high demand for imports. At worst, it would cause a global economic recession that impoverishes millions of people and makes Americans poorer.

NORBERT J. MICHEL is a Cato Institute vice president and director of Cato's Center for Monetary and Financial Alternatives.

INTRODUCTION

The trade deficit is the amount by which the value of a country's imports exceeds the value of its exports during a given period (one year, for example). It is a commonly misunderstood concept that inspires harmful policy ideas. Among these bad ideas are proposals for a country to balance trade by taxing capital flows. Policymakers propose such a tax to reduce foreigners' incentive to export to the taxing country, thereby reducing the trade deficit.

This type of proposal is highly flawed on theoretical, empirical, and practical grounds. To start with, the very notion of a trade deficit is merely part of a national accounting system, denoting that a country's consumers have higher demand for foreign goods than foreign consumers have for that country's goods. Taxing international capital flows would, at best, fail to change the incentives that drive domestic consumers' demand for imports. In the worst-case scenario, taxing capital flows, as has been proposed in the United States, would cause a global economic recession that threatens to impoverish millions of people and make Americans poorer. Either way, taxing foreign residents' purchases of US assets to balance America's trade flows would raise the cost of capital in the United States for a pointless economic goal.

CAPITAL FLOW TAX PROPOSAL

One recent example of a proposal to balance trade by taxing capital flows is a 2019 bill introduced by senators Tammy Baldwin (D-WI) and Josh Hawley (R-MO) called the Competitive Dollar for Jobs and Prosperity Act (S. 2357, 116th Congress).[1] Though the bill ultimately died in the Senate Banking Committee, similar legislation may be introduced in the future, so it is worthwhile to examine this legislation closely.

The bill did not focus on the trade balance itself, but on the current account, a broader category in the balance-of-payments framework that includes both trade and income flows. Specifically, the bill would have required the Federal Reserve to impose a tax on "foreign purchases of US stocks, bonds, and other assets" to achieve a current-account balance no later than five years after the bill was enacted.[2] It would have given the Fed the discretion to set (and regularly adjust) the tax rate to maintain this balance, defined as a current-account deficit (or surplus) no greater than an average of 0.5 percent of gross domestic product (GDP) in any five-year period.

A supporter of the bill, the Carnegie Endowment for International Peace's Michael Pettis, wrote in a 2019 essay:

> The trade shortfalls that plague the US economy are chiefly a product of imbalanced capital flows, which are driven by distortions in global savings. Selectively restricting capital inflows is the best way to address these imbalances.[3]

In other words, the purpose of the proposed tax was to reduce the capital that flows into the United States until it is nearly equal to the capital that flows out of the United States, thus equalizing imports and exports.

> "Proposals to balance trade by taxing capital flows are highly flawed on theoretical, empirical, and practical grounds."

Aside from whether this kind of tax could achieve the balance that such proposals' supporters desire, the stated goal is to lower the amount of funds available for investing in US assets. Put differently, the stated purpose is to make it more difficult for Americans to raise capital. Over time, the reduction in capital flowing into the United States would reduce productivity, resulting in slower real-wage growth and, therefore, a higher cost of living. Moreover, if the policy worked as designed, it would raise Americans' cost of living because the tax would diminish foreigners' incentives to export goods to America, thus increasing the prices of consumer goods. Because US producers import many of the goods they use to build their products, the reduction in US imports would also lead to higher product prices as (at least some of) those higher production costs are passed onto consumers. Given these effects, there is no reason to believe that Americans would be better off if these flows were somehow brought into balance. To the contrary, Americans would be worse off for the sake of achieving an economically pointless goal.

THEORETICAL AND PRACTICAL PROBLEMS WITH BALANCING CAPITAL AND TRADE FLOWS

Trying to ensure that the current account—or trade flows, or even just capital flows—is regularly balanced has no foundation in economic theory. A country's capital inflows do not have to match its capital outflows, just as a country's trade inflows (imports) do not have to match its trade outflows (exports). The failure of these flows to balance does not prevent a nation from reaching its maximum economic potential. Economically, it would make as little sense to try to balance these figures as it would to try to balance the goods or capital flows between Walmart and American consumers.

The residents of any country can, for instance, finance their own expenditures entirely through domestic markets regardless of whether the country's current account (or trade account) is in deficit or surplus with any other country. Even when consumers and businesses do rely on some external financing (directly or indirectly), their domestic spending on goods and services does not have to match these investment flows, just as Walmart can rely on external financing without balancing the amount investors contribute against what they spend in Walmart's stores.

Put differently, the source of Walmart's sales revenue is independent of its source of financing, just as Americans' demand for imports is independent of how Americans finance their purchases. Nonetheless, some might argue that when foreign investors use US dollars to buy, for example, American citizens' shares of Apple and Exxon, they help to finance Americans' purchases. Still, these types of share purchases do not have to balance against Americans' goods purchases, and it makes just as little sense to try to force them into balance as it would to make, for example, US pension funds' stock purchases balance Americans' goods purchases.

The flawed goal of balance is grounded in a long-running misconception that economically healthy nations must have roughly equal inflows and outflows of both capital and payments.[4] This fallacy has been exacerbated in modern times by a misunderstanding of the accounting framework used to create international (and national) economic accounts. These modern accounts can be traced to the 1920s, when the US Department of Commerce first published the balance-of-payments accounts, a system designed to measure the flow of goods and services abroad.[5] Many aspects of these accounts have an arbitrary nature to them that, if handled differently, would result in a very different set of accounting outcomes.

For instance, all real estate transactions are classified as capital purchases (or sales), but there is no reason these transactions could not be classified as consumption expenditures. Under the existing framework, if a Chinese resident buys a newly built house in the United States for $1 million, the transaction increases the United States' current-account deficit. If, however, the same transaction were recorded as a consumption expenditure, it would decrease the current-account deficit because it would be treated as an exported good (a US-produced good sold to a foreign resident). More broadly, if the overall accounting framework had been designed to track the *quantity* of goods instead of money exchanged for goods, a trade deficit would be referred to as a *goods surplus*. Regardless, a trade deficit does not indicate that anyone has lost anything or that anyone is owed anything.

> "It would make as little sense to try to balance these figures as it would to try to balance the goods or capital flows between Walmart and American consumers."

Setting aside the arbitrary nature of these concepts and naming conventions, the core accounting framework remains the same for what has evolved into the present-day international economic accounts. These accounts are still designed to keep track of where all the money in the economy is going and where it is coming from. Thus, in theory, these accounts must balance because they represent *all* the different flows.

Still, this accounting requirement does not mean US consumers must finance their spending from abroad to import more than they export. Similarly, the accounting requirement does not indicate that any amount of international financing must equal what any group of consumers spends on goods and services from abroad. Thus, on the surface, trying to make these amounts balance appears to be a misguided policy.

In practice, this type of policy would be problematic because even the accounting balance that exists in the international accounts is not so easily achieved. Table 1 helps illustrate this problem using the international accounts for the United States for 2022. It shows the three main accounts in the balance-of-payments framework: the current account, the capital account, and the financial account.

The current account tracks the value of exports and imports as well as certain income payments and receipts. It is the source of the term "trade deficit," the name used to describe when the value of a country's imports exceeds the value of its exports. (A trade surplus, on the other hand, would simply indicate that the value of exports exceeds the value of imports.)

As its name suggests, the capital account measures capital transfers between residents of various countries, including items such as debt forgiveness and grant payments.[6] The final balancing occurs (mainly) by comparing the combined current and capital account with flows reported in the financial account.

The financial accounts, where purchases and sales of financial assets are recorded, include the following three main subcomponents, as explained by the US Bureau of Economic Analysis:

- **Direct Investment.** The direct investment category reports financial transactions between "entities in a direct investment relationship that change assets or liabilities of the parent or affiliate."
- **Portfolio Investment.** The portfolio investment category reports "cross-border transactions involving debt or equity securities, excluding those included in direct investment or reserve assets."
- **Other Investment.** The other investment category is "a *residual* category that includes financial-account transactions other than those included in direct investment, portfolio investment, financial derivatives, and reserve assets."[7] (Emphasis added.)

Flows related to derivatives, as well as reserve assets (those purchased and sold by central banks), are reported separately in the financial account. The residual category—other investment—varies a great deal from year to year. During the previous five years, for instance, this residual category represented an average of 28 percent of the total acquisition of financial assets, ranging from 2 percent to 66 percent. As Table 1 suggests, these amounts are far from trivial; even in 2022, when the share for this residual category was just 4 percent of the total, the amount was more than $36 billion. In 2019, when the share was 66 percent, the total was more than $207 billion.

> "The accounting balance cannot be achieved without an additional residual account known as the statistical discrepancy, an amount that arises largely from errors, omissions, and inaccurate reporting systems."

The values and variation of this residual category should give pause to anyone who thinks a tax can be imposed to precisely balance these accounts. The situation is even more complex, though, because the accounting balance cannot be achieved without an *additional* residual account known as the statistical discrepancy, an amount that arises largely from errors, omissions, and inaccurate reporting systems.[8] The statistical discrepancy also tends to vary a great deal. During the previous five years it ranged from a negative value of $110 billion in 2019 (35 percent of the net acquisition of financial assets) to a positive value of $171.4 billion (20 percent) in 2022.

Table 2 presents the full balancing of these accounts for 2022. It subtracts US imports of $5.4 trillion from US exports of $4.42 trillion for a current-account deficit of $972 billion. Next, the current and capital accounts are summed, for a *combined* deficit of $976 billion.

To see exactly how the financial account offsets this deficit, the first step is to subtract the net acquisition of financial assets by the United States ($841 billion) from foreign residents' net incurrence of US financial liabilities ($1.56 trillion), resulting in a total of $724 billion. The next step is to add the statistical discrepancy ($171.4 billion), resulting in a total of $895.5 billion. Finally, the net derivatives-transaction amount ($81 billion) is added, producing a total of $976 billion, the figure that offsets

Table 1

United States international payment accounts, 2022

Millions of dollars

Current account			
Exports of goods and services and income receipts (credits)	**4,424,636**	**Imports of goods and services and income payments (debits)**	**5,396,231**
Exports of goods and services	3,018,455	Imports of goods and services	3,969,643
Goods	2,089,925	Goods	3,272,935
Services	928,530	Services	696,707
Primary income receipts	1,217,853	Primary income payments	1,069,300
Investment income	1,210,421	Investment income	1,045,819
Compensation of employees	7,432	Compensation of employees	23,481
Secondary income (current transfer) receipts	188,328	Secondary income (current transfer) payments	357,289
Capital account			
Capital transfer receipts and other credits	**8,400**	**Capital transfer payments and other debits**	**13,003**
Financial account			
Net US acquisition of financial assets, excluding financial derivatives	**840,582**	**Net US incurrence of liabilities, excluding financial derivatives**	**1,564,676**
Direct investment assets	426,251	Direct investment liabilities	388,078
Portfolio investment assets	372,494	Portfolio investment liabilities	810,154
Other investment assets (residual)	36,023	Other investment liabilities (residual)	366,445
Reserve assets	5,814	Financial derivatives other than reserves, net transactions	(80,698)
Statistical discrepancy	**171,406**		

Source: Bureau of Economic Analysis, "Table 1.1. US International Transactions," retrieved from International Data: International Transactions, International Services, and International Investment Position Tables.

the combined current- and capital-account deficit. This analysis makes clear that the balancing of these accounts is not nearly as straightforward as supporters of forcing trade into so-called balance would suggest.

Moreover, setting all these practical considerations aside, there is no good reason to expect the current account—or the trade in goods and services, the main component of the current account—to regularly balance. In fact, it appears that these accounts have *never* been in balance for the United States. The international account data reported by the Bureau of Economic Analysis shows that since 1960, the offsetting transactions in the current account were unequal every single year. Likewise, the import and export data available from the National Bureau of Economic Research (NBER) show that between 1901 and 1959, the accounts never balanced.[9] Finally, available records suggest that between 1790 and 1900, the accounts never balanced.[10]

It is true that some tax proposals seek instead to achieve small deficits or surpluses, but such policies require an arbitrary choice of some numerical value. The Baldwin-Hawley legislation, for example, arbitrarily chose "a current account deficit (or surplus) no greater than an average of 0.5 percent of GDP in any five-year period." Aside from any possible merits to using this approach or this percentage, a figure this low was achieved in only 14 of the 63 years between 1960 and 2022, nearly the entire post–World War II era. Furthermore, the 0.5 percent requirement is almost four times lower than the average percentage (1.91 percent) for the full period.[11]

Table 2

Balancing the 2022 United States international payment accounts

Millions of dollars

Calculation 1	
Exports less imports	
US exports of goods and services, plus income receipts	4,424,636
US imports of goods and services, plus income payments	5,396,231
Current-account deficit	**(971,595)**
Capital receipts less payments	
Capital transfer receipts and other credits	8,400
Capital transfer payments and other debits	13,003
Capital-account deficit	**(4,603)**
Combined current-account and capital-account deficit	**(976,198)**

Calculation 2	
Net US incurrence of liabilities, excluding derivatives	1,564,676
Net US acquisition of financial assets, excluding derivatives	840,582
Incurrence less acquisition	**724,094**
Plus statistical discrepancy	171,406
Subtotal	**895,500**
Plus net derivatives transactions	(80,698)
Offsetting "balance" for current and capital deficit	**976,198**

Source: Bureau of Economic Analysis, "Table 1.1. US International Transactions," retrieved from International Data: International Transactions, International Services, and International Investment Position Tables.

These basic data points further bolster the understanding that foreign residents and businesses are not simply reinvesting the $5.4 trillion Americans pay for imports into US financial markets. In other words, foreign investors are not directly financing US consumers' import purchases, as the supporters of taxing capital flows imply. It is true that US dollars end up on the international financial and commercial markets. But this is no more troubling than the fact that Walmart uses the dollars it earns in the eastern half of the United States to pay workers and invest in assets all over the world and does not try to balance those flows. In both cases, the notion that some sort of simple reciprocal economic arrangement is at play is simply wrong.

ECONOMIC REASONING AGAINST TAXING CAPITAL FLOWS

Currently, the United States has the deepest, most liquid, most secure financial markets in the world. This position makes it easier for both Americans and foreign residents to more accurately price assets, more efficiently allocate capital and diversify risks, and earn more income. It makes it easier for both Americans and foreign residents to invest internationally *and* domestically.

Simultaneously, the US dollar is the dominant reserve asset in foreign-exchange markets, and it is by far the dominant currency for invoicing and settling international trade.[12] All these features derive from America's open economy and stable institutions, and they are inextricably tied to the ability of people—both Americans and residents of foreign countries—to earn income and build wealth. These financial markets ultimately make it easier for people to create and buy more of the products and services that improve their lives.

> "There is no good reason to expect the current account—or the trade in goods and services—to regularly balance. In fact, it appears these accounts have never balanced for the United States."

These benefits also apply to secondary markets, where securities trades do not directly fund businesses. In other words, because of the depth and scope of US financial markets, people who purchase US financial assets by directly funding a business can typically sell those assets to someone else with little trouble. This ability to easily buy US financial assets—including everything from US Treasury securities to corporate stock and bonds—from their original owners creates a sort of feedback effect, making it even easier to raise capital in the first place. Naturally, the more foreign residents have access to these markets, the more liquid these markets become and the more they can improve foreign residents' ability to earn income, raise capital, and buy (and sell) goods and services.

Imposing a tax to suppress capital flows, therefore, would reduce both investment and consumption by Americans and residents of other countries.[13] That is, the tax would shrink *all* the activity that shows up in the balance-of-payments accounts. It would make people worse off by lowering the amount of goods and capital exchanged, as well as people's income. Notably, the cost of imposing a tax on international residents would raise the cost of capital for US investments, but that cost would not simply fall on the shoulders of foreign residents. Americans would suffer as the reduced demand for dollar-denominated assets would lower the real prices of these assets.

Ultimately, taxing international capital flows to balance trade flows would weaken the position of US financial markets and the dollar, diminishing all the economic benefits associated with its dominant position. Simply put, this kind of policy would make it more difficult for people to invest in the United States, making both Americans and foreign residents poorer. Even if balancing the trade deficit were a worthy economic goal, policymakers should strive to avoid making it more difficult for people to invest in the United States. Regardless, the empirical evidence does not support the notion that balancing trade flows is a worthy economic goal.

BASIC EMPIRICAL EVIDENCE

Conceptually, it is a mistake to associate foreign countries' aggregate savings and investment relationships with individual choice. In other words, foreign residents and businesses do not choose to sell Americans goods and services so that they can simply turn around and invest their proceeds in American financial assets. That sort of reciprocity is not what drives the US economy or even, for that matter, the United States' balance-of-payments outcomes. It is not the case that the exporters from foreign countries are literally financing Americans' purchases of goods and services.[14]

There is no solid empirical support for the notion that trade deficits (or surpluses) cause economic problems. The United States has run a trade deficit for most of its history, through all phases of its many business cycles. For instance, on an annual basis, the United States ran a trade surplus only twice from 1790 to 1819, 11 times from 1820 to 1860, and 23 times from 1861 to 1900—a surplus in just 36 out of those 108 years.[15] In the post–World War II era, specifically from 1960 to 2022, the United States ran a trade surplus in just 13 out of 63 years. Yet in the 1930s, one of the most dismal economic periods on record, the US had a trade *surplus* for 102 of the decade's 120 months.[16]

Still, supporters of restricting US trade continue to exploit the negative-sounding term "trade deficit." They often argue that policies to balance imports and exports are necessary to protect American workers in manufacturing.[17] But they ignore the fact that most industrialized countries are experiencing a downward trend in manufacturing jobs—very much as America did after 1979—*despite* consistently experiencing trade surpluses.[18] For instance, the same type of employment declines are found in "countries such as Germany, Japan, and

Italy, which have had trade surpluses in manufacturing trade that, between 1973 and 2010, averaged 7.6, 6.2, and 4.2 percent of their GDPs, respectively."[19] From 1994 to 2018, in a nine-country sample of developed and underdeveloped nations, some with trade surpluses and others with trade deficits, all but India displayed a decline in the percentage of their population employed in manufacturing.[20]

Separately, as international trade increased in the 1980s, the share of manufacturing employment in the United States fell at nearly the same rate (0.4 percentage points per year) as it did in the 1960s and 1970s, when the country experienced a much lower share of trade in the economy.[21] The US data also show that the respective shares of imports and exports to GDP rose almost in tandem from 1960 to 2018.[22] Thus, US manufacturing employment has fallen while both imports and exports (as a share of the economy) have been rising at nearly the same rate. Internationally and domestically, there simply is no clear negative relationship between a trade imbalance and a nation's manufacturing employment.

CONCLUSION

Because US residents and businesses pay for their imports with US dollars, hundreds of billions of dollars regularly flow out of the United States and into many other countries. It is true that, in the balance-of-payments framework, this surplus of dollars ultimately helps offset—that is, balance—the aggregate trade deficit. However, these concepts balance each other only in that the national accounting framework is designed to track all flows, *not* because people are engaged in reciprocal investments after selling goods to Americans.

Critics who call for taxing capital flows to balance the trade deficit misunderstand a completely benign accounting artifact that happens to sound negative. In truth, though, neither a trade deficit nor a capital surplus plagues the American economy. Imposing a tax on foreign residents' purchases of US assets threatens all the economic benefits associated with the US dollar's renowned status for both Americans and foreign residents. As there is no economic reason aggregate international capital and trade flows should balance, this misguided trade policy would directly raise the cost of capital in the United States for a pointless goal.

> "The cost of imposing a tax on international residents would raise the cost of capital for US investments, but that cost would not simply fall on the shoulders of foreign residents."

US financial markets are the most liquid and secure in the world, and the US dollar is the most sought-after national currency, making it even easier for foreign residents to invest in the United States. This status helps both Americans and foreign residents more efficiently allocate capital and diversify their risks, increasing their ability to earn income and build wealth. This strength, derived from America's open economy and stable institutions, ultimately makes it easier for more people to buy more of the products and services that improve their lives. Imposing a tax to suppress capital flows would mitigate these benefits, reducing both investment and consumption by Americans and foreign residents and leaving everyone poorer.

NOTES

1. Senator Tammy Baldwin (D-WI), "US Senators Tammy Baldwin and Josh Hawley Lead Bipartisan Effort to Restore Competitiveness to US Exports, Boost American Manufacturers and Farmers," press release, July 31, 2019.

2. Senator Tammy Baldwin (D-WI), "US Senators Tammy Baldwin and Josh Hawley Lead Bipartisan Effort to Restore Competitiveness to US Exports, Boost American Manufacturers and Farmers," press release, July 31, 2019.

3. Michael Pettis, "Washington Should Tax Capital Inflows," Carnegie Endowment for International Peace, August 6, 2019. According to Pettis, because the "capital account and current account must always match up exactly," taxing capital flows would ensure that "the US trade deficit would disappear."

4. The flawed concept dates at least as far back as the 1700s. For instance, Adam Smith wrote, "Nothing, however, can be more absurd than this whole doctrine of the balance of trade, upon which, not only these restraints, but almost all of the other regulations of commerce are founded." See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan (New York: Modern Library, 1994), p. 521.

5. Bureau of Economic Analysis, *US International Economic Accounts: Concepts and Methods* (Washington: Department of Commerce, June 2022), p. 4.

6. It also reports the acquisition and disposal of non-produced non-financial assets (such as natural resources, leases, and licenses). Bureau of Economic Analysis, *US International Economic Accounts: Concepts and Methods* (Washington: Department of Commerce, June 2022), p. 147.

7. Bureau of Economic Analysis, *US International Economic Accounts: Concepts and Methods* (Washington: Department of Commerce, June 2022), pp. 150, 160, and 169, respectively.

8. Bureau of Economic Analysis, *US International Economic Accounts: Concepts and Methods* (Washington: Department of Commerce, June 2022), pp. 184–185.

9. NBER Macrohistory: VII. Foreign Trade, National Bureau of Economic Research, US Total Imports 07/1866–10/1969 and US Total Exports 07/1866–10/1969.

10. Douglass C. North, "The United States Balance of Payments, 1790–1860," in *Trends in the American Economy in the Nineteenth Century*, ed. the Conference on Research in Income and Wealth (Princeton: Princeton University Press: 1960), p. 577 (Table 1); and Matthew Simon, "The United States Balance of Payments, 1861–1900," in *Trends in the American Economy in the Nineteenth Century*, ed. the Conference on Research in Income and Wealth (Princeton: Princeton University Press: 1960), pp. 699–705 (Table 27).

11. This average refers to the absolute value of the annual surplus (or deficit) as a share of GDP from 1960 to 2022, using the difference between the "Exports of goods and services and income receipts (credits)" and "Imports of goods and services and income payments (debits)" as reported by the Bureau of Economic Analysis in the current account.

12. The euro is the only exception to the US dollar's dominant use in international trade, and its use surpasses the dollar only in Europe (in the aggregate). Carol Bertaut, Bastian von Beschwitz, and Stephanie Curcuru, "The International Role of the US Dollar," *FEDS Notes*, Board of Governors of the Federal Reserve System, October 6, 2021; and Bafundi Maronoti, "Revisiting the International Role of the US Dollar," *BIS* [Bank for International Settlements] *Quarterly Review* (December 2022): 36–37.

13. Imposing a tax to make investing in US assets more expensive is also akin to closing American markets through a capital-control regime, a policy that has repeatedly produced poor economic results throughout the world while failing to alter the volume of capital outflows. See Nicolas Magud and Carmen M. Reinhart, "Capital Controls: An Evaluation," in *Capital Controls and Capital Flows in Emerging Economies*, ed. Sebastian Edwards (Chicago: University of Chicago Press, 2007), pp. 645–674; and Sebastian Edwards, "How Effective Are Capital Controls?," *Journal of Economic Perspectives* 13, no. 4 (Fall 1999): 65–84.

14. It is also true that net financial inflows to the United States (ranging from $0.5 trillion to $1.9 trillion per year for the last decade) are a relatively small portion of the total size of the US capital market ($40.3 trillion) and total US commercial bank credit ($17.3 trillion). See SIFMA Research, *2023 Capital Markets Fact Book* (New York: SIFMA, July 2023); and Board of Governors of the Federal Reserve System, "Bank Credit, All Commercial Banks (TOTBKCR)," retrieved from FRED, Federal Reserve Bank of St. Louis, August 20, 2023.

15. The figures for 1790–1819 and for 1820–1860 are taken from Douglass C. North, "The United States Balance of Payments, 1790–1860," in *Trends in the American Economy in the Nineteenth Century*, ed. the Conference on Research in Income and Wealth (Princeton: Princeton University Press: 1960), p. 577 (Table 1) and p. 605 (Table B-1), respectively; the figures for 1861–1900 are from Matthew Simon, "The United States Balance of Payments, 1861–1900," in *Trends in the American Economy in the Nineteenth Century*, ed. the Conference on Research in Income and Wealth (Princeton: Princeton University Press: 1960), pp. 699–705 (Table 27).

16. Don Boudreaux, "If Trade Surpluses Are So Great, the 1930s Should Have Been a Booming Decade," Cafe Hayek, December 21, 2006. It is also the case that in the years leading up to, during, and between the two world wars, the United States typically ran a trade surplus.

17. Senator Tammy Baldwin (D-WI), "US Senators Tammy Baldwin and Josh Hawley Lead Bipartisan Effort to Restore Competitiveness to US Exports, Boost American Manufacturers and Farmers," press release, July 31, 2019.

18. Robert Z. Lawrence, "Recent Manufacturing Employment Growth: The Exception That Proves the Rule," National Bureau of Economic Research Working Paper no. 24151, December 2017, p. 9.

19. Robert Z. Lawrence, “Recent Manufacturing Employment Growth: The Exception That Proves the Rule,” National Bureau of Economic Research Working Paper no. 24151, December 2017, p. 9.

20. Author’s calculations using World Bank, “Net Trade in Goods and Services (BoP, Current US$),” 2000–2018, retrieved from International Monetary Fund’s Balance of Payments Statistics Yearbook and Data Files; and International Labour Organization, “SDG Indicator 9.2.2—Manufacturing Employment as a Proportion of Total Employment (%)—Annual,” 2000–2018, retrieved from ILOSTAT. The countries included are Brazil, Canada, Germany, India, Japan, Pakistan, Russia, Switzerland, and the United Kingdom. From 1994 to 2018, some of the countries consistently ran a surplus, some typically showed a deficit, and others varied.

21. Robert Z. Lawrence, “Recent Manufacturing Employment Growth: The Exception That Proves the Rule,” National Bureau of Economic Research Working Paper no. 24151, December 2017, p. 6.

22. The import and export data are almost perfectly correlated (the correlation coefficient is 99 percent). Author’s calculations using Bureau of Economic Analysis, “Table 1.1.5. Gross Domestic Product,” 1960–2018, retrieved from National Data: GDP & Personal Income; and Bureau of Economic Analysis, “International Trade in Goods and Services,” retrieved from Current Release: US Trade in Goods and Services, 1960–present.

RELATED PUBLICATIONS FROM THE CATO INSTITUTE

The Reality of American "Deindustrialization" by Colin Grabow, Globalization: Then and Now (October 24, 2023)

Comparative Advantage by Donald J. Boudreaux, Defending Globalization: Economics (September 12, 2023)

Balance of Trade, Balance of Power: How the Trade Deficit Reflects US Influence in the World by Daniel Griswold and Andreas Freytag, Policy Analysis no. 944 (April 25, 2023)

The (Updated) Case for Free Trade by Scott Lincicome and Alfredo Carrillo Obregon, Policy Analysis no. 925 (April 19, 2022)

International Trade and Investment Policy by Scott Lincicome, James Bacchus, Gabriella Beaumont-Smith, Colin Grabow, Daniel Griswold, and Clark Packard, *Cato Handbook for Policymakers* (2022)

Assessing President Trump's Trade Priorities by Daniel Griswold, *Cato Journal* (Winter 2019)

RECENT STUDIES IN THE CATO INSTITUTE POLICY ANALYSIS SERIES

963. **Misperceptions of OPEC Capability and Behavior: Unmasking OPEC Theater** by David Kemp and Peter Van Doren (November 2, 2023)

962. **Are Public School Libraries Accomplishing Their Mission? Public School Libraries Do Not Appear to Stock a Balance of Views** by Neal McCluskey (October 17, 2023)

961. **Pariah or Partner? Reevaluating the U.S.-Saudi Relationship** by Jon Hoffman (September 20, 2023)

960. **Expand Access to Methadone Treatment: Remove Barriers to Primary Care Practitioners Prescribing Methadone** by Jeffrey A. Singer and Sofia Hamilton (September 7, 2023)

959. **Sweden during the Pandemic: Pariah or Paragon?** by Johan Norberg (August 29, 2023)

958. **Terrorism and Immigration: A Risk Analysis, 1975–2022** by Alex Nowrasteh (August 22, 2023)

957. **Corking Russian Gas: Global Economic and Political Ramifications** by Scott Semet (August 17, 2023)

956. **A Link Tax Won't Save the Newspaper Industry: The Journalism Competition and Preservation Act Will neither Promote Competition nor Preserve Newspapers** by Paul Matzko (August 14, 2023)

955. **Freeing American Families: Reforms to Make Family Life Easier and More Affordable** by Vanessa Brown Calder and Chelsea Follett (August 10, 2023)

954. **Tax Expenditures and Tax Reform** by Chris Edwards (July 25, 2023)

953. **2022 Arms Sales Risk Index** by Jordan Cohen and A. Trevor Thrall (July 18, 2023)

952. **Adverse Effects of Automatic Cost-of-Living Adjustments to Entitlement and Other Payments** by John F. Early (June 22, 2023)

951. **Indian Nationalism and the Historical Fantasy of a Golden Hindu Period** by Swaminathan S. Anklesaria Aiyar (June 21, 2023)

CITATION

Michel, Norbert J. "Trade and Investment Are Not a Balancing Act," Policy Analysis no. 964, Cato Institute, Washington, DC, November 9, 2023.