

A Deficit of Good Trade Data

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It may sound counterintuitive, but the more that production processes are spread across national boundaries through global value chains, the more integrated the US economy becomes with other economies in the world. Having so many firms lead and participate in global value chains is an American strength. Like any successful business, U.S. firms are focused on maximizing the value they create while minimizing the costs to do it. What they aren't doing is keeping track of the trade balance.

“Significant Trade Deficits”

In 2016, the United States ran a trade deficit of [\\$500.6 billion](#). Should we be concerned? The President recently issued an Executive Order instructing our trade agencies to single out countries we run a deficit with, to figure out why that is, and to determine what impact it may have on the strength of America's manufacturing capacity.

The implications of this exercise are two-fold. First, that the deficit results from unfair trade practices. Second, that we need to do something about it. There's disagreement on both points. The numbers the government will use for the analysis will further cloud the debate. The methodology for reporting trade flows is seriously outdated for a country that leads the world in harnessing data for useful purposes.

Fuzzy Math

The most common way to keep a national accounting of trade is to report the gross commercial value of goods and services as they exit and enter the country as if everything being traded is a finished product.

But only one quarter of the goods and services traded globally are finished products. This method ignores that three-quarters of global trade is inputs or intermediary goods and services that make up parts of the overall production process. Most products crisscross the global before becoming final (we use the example of [cars made in North America](#) that go back and forth between the United States, Canada, and Mexico in another Essential). That means the inputs could be counted multiple times.

Our current method of measuring the trade balance might only accurately apply to around 25 percent of what we trade. But companies that sell goods and services make a profit and pay their employees based on 100 percent of what they earn. And, why should the country that puts on the final touch to a product get all of the statistical credit?

A Modern Definition of “Made in America”

The dynamism of global trade today is obscured in the way we currently count exports and imports. So how do we capture the full value to the U.S. economy of all types of economic activity?

Value added trade data provide a clearer view of global production relationships. New methodologies developed in the OECD and WTO disaggregate the data in four ways.

The data count:

- Domestic value of an intermediate or final product consumed in the country that imported it. If we use car

production, we could think of this as an American car component sold to a German mechanic who uses it to fix a car in Germany.

- Domestic value that moved on from the first importing country to other countries for further production or consumption. That same American auto component could get used in the production of a German car sold in Korea.
- Domestic value that made a return trip to the US economy through imports. The American auto component is used in production of a car in Sweden that is shipped to a customer in the United States.
- Foreign value (an import) that ended up in a US export. An American engine manufacturer buys a Japanese component for use in an American car shipped to Mexico.

There isn't a common statistical framework for reporting trade data this way – yet – and it requires a reliable method for collecting firm-level data without too much time lag. But if wearable workout devices can tell you when you're dehydrated or tired, this should be feasible in today's world.

Globally, smart economists are on the case. Economist [Lucian Cernat](#) has been promoting a shift to this approach in Europe. He argues that global tracking technologies deployed in shipping and all the way to retailer's shelves or off the UPS truck to our zip codes, should make it possible to change the way we understand global trade flows at the firm level.

Presto-Chango: a Political Fix for the Trade Balance

If President Trump wanted to reduce the U.S. deficit with Mexico or China, all he has to do is change the way we count it.

Here are three ways to count the deficit with Mexico. 2011 is the latest year for which the OECD has trade in value added data, so we'll compare it with U.S. Census trade data for 2011. If we instead use "domestic exports" (counts only value created in the U.S.) and imports for consumption (nothing that came in and went out without much or any modification), the deficit was \$102.3 billion. If we use the more common measure of total U.S. exports and general U.S. imports by customs value, the deficit with Mexico was \$64.5 billion. If we calculate the deficit the trade in value added way, the deficit is just \$15.6 billion. That's either a 75.8% drop or you've shaved 84.8% off the deficit and nothing changed about what we import or export.

The same effect will occur with China. We ran a whopping \$295.3 billion trade deficit with China in 2011 (using the general export and import measure), but running it through the trade in value added methodology, the deficit is \$28 billion – a difference of 90.5%. Why? Because China's manufactured exports contain a great deal of value added by other countries (including from the United States) before the product is exported to the United States.

A good example of this is Apple's iPad, the production chain of which is explained in interesting detail in *The Economist* article, "[iPadded](#)." An iPad imported into the United States adds \$275 to the U.S. deficit (the total cost of production), but the value added in China amounts to just \$10. *The Economist* estimated that iPads accounted for around \$4 billion of the overall U.S. trade deficit with China in 2011. Measured as trade in value, that deficit would actually be just \$150 million.

Micro Data, not Micro Manage

We are not suggesting that trade imbalances be used to measure the health of the US economy or the merits of trade policy (see our Essential on [Not Using the Trade Deficit to Keep Score](#)). The current accounting is an exercise that has little practical utility for American companies or in our daily lives. Political commentator George Will once said he runs a persistent trade deficit with his barber – “I pay him to cut my hair, but he doesn’t buy anything from me.”

In business, managing to an outcome is the goal, not measuring the activity. But in trade policy, introducing new ways of evaluating trade flows would help us better understand business decisions in the modern economy, where the bottlenecks in trade flows are at the firm level, and how trade policies and agreements affect our communities at the local level versus economy-wide. After all, countries don’t trade, people trade.

That’s a good reason why trade data shouldn’t begin and end at the border. It should be tracked all the way to where value is created and that’s in our communities. If we do that, trade policy of the future can focus on the people and companies engaging in it and not on keeping score between countries.