The Balance of International Payments Is Economic Nonsense

Let us define the set of all human beings whose height is greater than 170 cm and less than 180 cm. Call this set A. Now let us collect data on all the dealings between members of set A and members of set B, which consists of all human beings whose height is less than or greater than those in set A. What economic significance can we ascribe to the aggregate of monetary flows between members of set A and members of set B? Correct answer: none. This aggregation of persons who trade with persons in the complementary set has no economic meaning; the sets are arbitrary so far as economic understanding is concerned. People—individuals, firms and other organizations, and governments—trade in order to improve their economic condition. Whether they trade with shorter or taller people or with people within a certain height range or outside this range has nothing to do with economics or human well-being. To draw up a balance of interest payments for set A and set B, or any given subset of B would serve no purpose. It would be a nonsensical exercise.

Now let us define the set of all human beings who reside within the boundaries of a certain nation-state, say, the United States of America. Call these people the elements of set P. Now collect data on all the dealings between members of set P and members of set Q, which consists of all human beings who reside outside the USA. What economic significance can we ascribe to the aggregate of monetary flows between members of set P and members of set Q? Correct answer: none. This aggregation of persons who trade with persons in the complementary set has no economic meaning; the sets are arbitrary so far as economic understanding is concerned. People—individuals, firms and other organizations, and governments—trade in order to improve their economic condition. Whether they trade with people inside or outside the USA has nothing to do with economics or human well-being. To draw up a balance of interest payments for set P and set Q, or any given subset of Q (e.g., residents of China or Mexico) would serve no intellectual purpose. It would be a nonsensical exercise.

Yet exactly such a nation-based “balance of international payments” accounting system has been constructed and “analyzed” for a very long time. In centuries past, when kings needed to accumulate gold and silver to pay mercenaries to fight their wars, they had a reason to accumulate such data and to promote policies (such as customs duties on imported goods) that would discourage imports, thereby keeping gold and silver from flowing out of the country in payment for the imports. This sort of “political arithmetic” eventually grew into the modern system of international balance of payments accounts (indeed, the entire system of national income and product accounts, as well). The old monarchical logic for the collection of such data has long since evaporated, however. Modern governments have other ways to organize and finance their wars.

Meanwhile, other interested parties discovered that they might use certain conditions, such as a so-called deficit in the balance of trade (the value of national imports of goods and services exceeds the value of national exports of goods and services) as rhetorical fodder to feed their politicking for the government to place greater tariffs (import taxes) on goods and services imported into the home country that compete for domestic sales with the goods offered for sale by domestic sellers. This gambit is nothing but a means of suppressing competition, an activity in which sellers unfortunately commonly engage, employing the government's force in their quest if they can enlist it. This so-called protectionism obviously hurts domestic consumers by depriving them of access to better terms of trade otherwise available from foreign sellers.

Recall, however, what was already said: every trade, whether with members of one's own set or members of another, complementary set, is undertaken in the expectation of gain. The idea that even though every transaction was voluntarily entered into for mutual gain there is something wrong if the aggregate value of exports from one's set falls short of the imports is, to speak frankly, preposterous. One cannot add up a number of gainful exchanges, whether they be purchases or sales, and conclude that in the aggregate a baleful situation has been created. To give this impression is nothing but a trick, a diabolical scheme, by which some sellers in effect hope to pick the pockets of domestic consumers.

The root of this evil is the aggregation that is employed in such balance of payments accounting systems. Nations as such don't gain or lose from trade; only individual traders do. If the trades into which these people voluntarily enter entice them by the prospect of mutual gain, it simply cannot be the case that the sum total of their transactions amounts to a bad deal.