

Measuring Balance of Payments Deficits

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What is a Balance of Payments Deficit?

Balance-of-payments (BOP) deficits have occupied the attention of policymakers and economists for decades, and recent developments have brought renewed interest to the question of how they should be measured and when they become a cause for concern. The BOP is an accounting framework that tracks all economic transactions between United States persons and the rest of the world on a double-entry bookkeeping basis. Much as double-entry bookkeeping helps businesses manage their accounts, the BOP accounting framework organizes international transactions. Under the BOP accounting framework, the balance of payments (as an accounting identity) must balance. A BOP deficit, therefore, does not refer to the accounting identity itself, but to a deficit in a particular subset of transactions. Measuring a BOP deficit requires choosing which subset is economically relevant for the question at hand.

Today, transactions constituting the BOP are grouped into three main categories: the current account, the capital account, and the financial account.¹ The current-account balance is the net position of (i) goods trade, (ii) services trade, (iii) primary income, and (iv) secondary income. Primary income consists of international investment income and labor compensation, while secondary income reflects unilateral transfers (e.g., insurance payments, foreign aid, remittances). Because the BOP must balance to zero, net lending or borrowing measured from the current and capital accounts must be exactly offset by corresponding transactions in the financial account. For example, if a U.S. company sells a \$50,000 car abroad, the car's movement abroad enters as \$50,000 of goods exports in the current account while the compensating movement of dollars to the United States enters as a \$50,000 currency acquisition in the financial account.

A deficit in the current account has long been a widely accepted measure of a BOP deficit.² Alternative BOP deficit measures often use the current account as a starting point, and include certain elements of the capital and financial accounts. These measures include:

- The **liquidity balance** measured changes in all U.S. liquid liabilities to foreigners (not just those held by official institutions) plus changes in U.S. reserve assets. This attempted to capture the total potential claim on U.S. reserves, but was criticized for mixing economically distinct categories.
- The **official reserve transactions balance** tracked the net disposition of dollars by the federal government to manage the foreign exchange value of the dollar. After the United States' move to floating rates in 1973, the measure lost much of its policy relevance because exchange rate management was no longer the primary objective.

¹ Throughout, each of these components of the BOP accounting framework are referred to as they are defined by the Bureau of Economic Analysis in the U.S. International Economic Accounts: Concepts and Methods, <https://www.bea.gov/resources/methodologies/international/pdf/iea-concepts-methods.pdf>.

² For example, the International Monetary Fund has included references to "balance of payments deficits on [the] current account" in its annual reports across each decade since at least the 1950s. See, e.g., International Monetary Fund, Annual Report 1952; Patricia Hagan Kuwayama, Measuring the United States Balance of Payments, Fed. Res. Bank N.Y. Monthly Rev., Aug. 1975, at 183, 186–187; Donald S. Kemp, Balance-of-Payments Concepts—What Do They Really Mean?, Fed. Res. Bank St. Louis Review, July 1975, at 14, 19. Since 2012, the IMF has produced External Sector Reports annually, which center on staff assessments on current-account balances and real exchange rates.



- The **basic balance** was once one of the most widely used measures in the context of measuring “balance of payments deficits.” The basic balance was a construct that combined the current account with long-term capital flows (primarily a subset of components of the financial account), intending to isolate the persistent, structural component of a country’s external position from short-term or speculative financial movements.

The latter measure, the basic balance, played a prominent role in policy discussions for several decades in the United States and in other countries, including the United Kingdom and Germany, and at international institutions like the International Monetary Fund (IMF) and the Bank for International Settlements (BIS).³

Yet by 1976, the Bureau of Economic Analysis (BEA) had formally discontinued publication of all three of those alternative BOP measures. The official reserve transactions balance and liquidity balance lost their conceptual foundation after the move to floating rates,⁴ as both were designed to measure pressure on official reserves that were no longer committed to defending a fixed parity.

The BEA also discontinued publication of the basic balance, citing the increasingly arbitrary nature of separating short- and long-term assets by maturity and marketability, and describing the existing measures as often giving “conflicting evidence on the payments flows of the nation for a given quarter or year” and being “far too volatile in short time periods to provide a reliable gauge of longer run developments.” The BEA further noted that within the context of evolving financial markets and capital mobility, it had become “increasingly difficult to distinguish between transactions in liquid and illiquid assets.”⁵

Accordingly, the basic balance was abandoned not because what it was seeking to measure ceased to matter, but because financial market deepening and innovation had liquefied the very asset classes on which its classifications depended, rendering the distinction between “long-term” and “short-term” capital increasingly arbitrary and obsolete.

Why the Basic Balance Was Abandoned and Cannot Be Perfectly Reconstructed

The basic balance hinged on the assumption that original instrument maturity could reliably distinguish structural from speculative flows. In practice, this proved impossible. As the Federal Reserve Bank of New York’s Kuwayama wrote in 1975, long-term bonds can be used as short-term positions, short-term loans can be rolled over indefinitely, portfolio flows can be vehicles for currency speculation, and formal maturity

³ The Bank of England formally introduced it in 1959; the Deutsche Bundesbank routinely published a “Net basic balance” defined as current items plus long-term capital; BIS annual reports referred regularly to countries’ “basic balance-of-payments” positions; and the IMF treated the distinction as analytically relevant in staff work, including a 1969 paper exploring the relationship between the basic balance and reserve movements. See Deutsche Bundesbank, Monthly Report (Feb. 1965); Bank of England, “The Balance of Payments: Methods of Presentation,” Quarterly Bulletin 4, no. 2 (1964); Bank for International Settlements, Annual Reports (1960s); IMF Staff Paper, “Basic Balances, Short-Term Capital Flow, and International Liquidity” (1969).

⁴ The United States moved to a floating exchange rate in March 1973 and has maintained a floating exchange rate ever since. See, e.g., Office of the Historian, U.S. Department of State. “Nixon and the End of the Bretton Woods System, 1971-1973.” Milestones in the History of U.S. Foreign Relations <https://history.state.gov/milestones/1969-1976/nixon-shock>.

⁵ Bureau of Economic Analysis. U.S. International Economic Accounts: Concepts and Methods. Washington, D.C.: U.S. Department of Commerce (Sept. 2014).



therefore cannot be identified with the true motivation of the flow.⁶ The long-term capital category included foreign direct investment (FDI) on the premise that it was stable, yet measured FDI contained large, volatile intracompany flows between parent firms and subsidiaries that functioned as short-term treasury management. Some members of the 1976 Advisory Committee argued “there [was] no conceptual basis for combining current-account transactions with long-term capital transactions in the same balance than there would be for combining all short-term and long-term transactions within the capital account itself.”⁷

These problems have grown immeasurably worse since. Financial market deepening has liquefied the very asset classes on which the basic balance’s classifications depended: securities markets now permit positions to be unwound in seconds, derivatives allow synthetic replication of any exposure regardless of stated maturity, and the class of assets convertible into money-like claims has expanded far beyond what the original architects envisioned. If the distinction between “long-term” and “short-term” capital was already, in the Bank of England’s 1970 assessment, “increasingly unrealistic and arbitrary,” it is today even less realistic and more arbitrary.⁸

Why do Balance of Payments Deficits Continue to Matter Today?

Although some previously common measures of the BOP deficit no longer have relevance, the concept of a BOP deficit itself still matters today. As the Federal Reserve Bank of New York argued in 1975, the move to managed floating exchange rates did not make balance-of-payments concepts obsolete; rather, it changed their analytical use. Under Bretton Woods, these measures were used to identify “fundamental disequilibrium” relative to fixed parity.⁹ Under floating rates, their more important function was to “anticipate sources of future exchange rate change and the potential impact of international developments on domestic economies.”¹⁰ Indeed, the New York Fed emphasized that the analytical frameworks developed under Bretton Woods remained applicable in a floating exchange rate regime, arguing that “the same characteristics—short-run sensitivity to interest rates and exchange rate expectations—are as important in the case of floating exchange rates as in the Bretton Woods framework.”¹¹ It maintained that “it is still desirable to separate payments according to how stable or volatile they are, and how responsive to short-run changes in monetary policy,” and that “the basic balance, as well as other variants of this concept, is just as natural a basis for analysis in the world of floating exchange rates as it was under fixed exchange rates.”¹² The relevant question in the New York Fed’s framing was whether a country’s external accounts revealed pressures likely to affect future exchange rates, monetary conditions, or domestic economic performance.

However, like the BEA recognized a year later when it chose to discontinue reporting of the basic balance, the New York Fed also recognized the limitations of existing measures in separating “stable” long-term

⁶ Patricia Hagan Kuwayama, “Measuring the United States Balance of Payments,” *Monthly Review* (Federal Reserve Bank of New York) 57, no. 8 (Aug. 1975): 192 https://www.newyorkfed.org/medialibrary/media/research/monthly_review/1975_pdf/08_3_75.pdf

⁷ June 1976 Survey of Current Business, Report of the Advisory Committee on the Presentation of Balance of Payments Statistics, p. 26.

⁸ Bank of England. “Commentary.” *Bank of England Quarterly Bulletin* 10, no. 3 (September 1970).

⁹ Kuwayama, “Measuring the United States Balance of Payments,” *Monthly Review* (Federal Reserve Bank of New York) 57.

¹⁰ Kuwayama, “Measuring the United States Balance of Payments,” *Monthly Review* (Federal Reserve Bank of New York) 57.

¹¹ Kuwayama, “Measuring the United States Balance of Payments,” *Monthly Review* (Federal Reserve Bank of New York) 57.

¹² Kuwayama, “Measuring the United States Balance of Payments,” *Monthly Review* (Federal Reserve Bank of New York) 57.



flows from short-term “volatile” flows acknowledging that while the concept of the basic balance “represents the ideal,” it remains flawed by measurement problems. Instead, the New York Fed posited that balance-of-payments flows might best be measured by the sum of the current account and capital account, as these are “the only measured flow categories that can be regarded as largely interest insensitive.”¹³

As the IMF has recognized, even countries with fully-flexible exchange rates and open capital accounts remain vulnerable to BOP crises marked by capital-flow shocks and sudden stops; a floating currency regime can mitigate those episodes, but it does not eliminate external-crisis risk.¹⁴ Countries *under any currency and policy regime* may experience BOP deficits and international payments problems.

What Alternate Measures Are Currently Available to Capture the Balance of Payments Deficit?

As noted, a current-account deficit has long been a universally accepted measure of a BOP deficit, and CEA staff have concluded that the current-account balance remains the most reasonable and reliable approach for determining a BOP deficit today. Nevertheless, CEA staff have analyzed how one might reconstruct the concept of the basic balance, which (as noted above) was defined as the current-account balance plus long-term capital flows. While the concept of the current account has largely remained the same since the 1970s, there is no single measure of the long-term capital (the other main component of the basic balance), and BEA no longer reports all the components needed to exactly replicate the basic balance. Even if the necessary components were reported by the BEA, it is unlikely any of these components would credibly be included as “long-term capital” in the context of modern financial markets. CEA staff considered multiple interpretations of what, in the modern context, should be included to measure the BOP deficit, following the contemporary understanding of the BOP basic balance during the decades it was in use.

What can be construed as non-volatile, long-term capital has changed materially since the 1970s. The deepening of the financial market has liquefied many balance-sheet claims, expanding the class of payment and money-like instruments. CEA staff believe that any measures of BOP deficits should capture only the most durable, illiquid, and long-term claims under current market conditions, in order to isolate instruments that can currently be used as or quickly converted into (*i.e.*, liquidated) money-like claims. At present, the capital account certainly consists of long-term capital, though the BEA did not begin publishing a separate measure for the capital account (removing a small portion of the unilateral transfers measure from the current account) until July 1999 and the capital account’s associated flow is small relative to the current account. Therefore, in practice, a measure including the current- and capital-account balance would not be materially different than reporting only the current account. CEA staff also view some components of FDI as long-term capital because not all FDI is liquid. That said, as BEA noted in 1976, when it chose to discontinue reporting of the basic balance, “even some components of direct investment[] can be quite volatile.”¹⁵ CEA staff have no credible way—and are aware of no credible way, given currently

¹³ Kuwayama, “Measuring the United States Balance of Payments,” Monthly Review (Federal Reserve Bank of New York) 57.

¹⁴ See, e.g., Antonio David, and Carlos Goncalves, *In Search of Lost Time: Examining the Duration of Sudden Stops in Capital Flows*, IMF Working Papers 2019, 230 (2019), <https://doi.org/10.5089/9781513516080.001>.

¹⁵ June 1976 Survey of Current Business, Report of the Advisory Committee on the Presentation of Balance of Payments Statistics, p. 26.



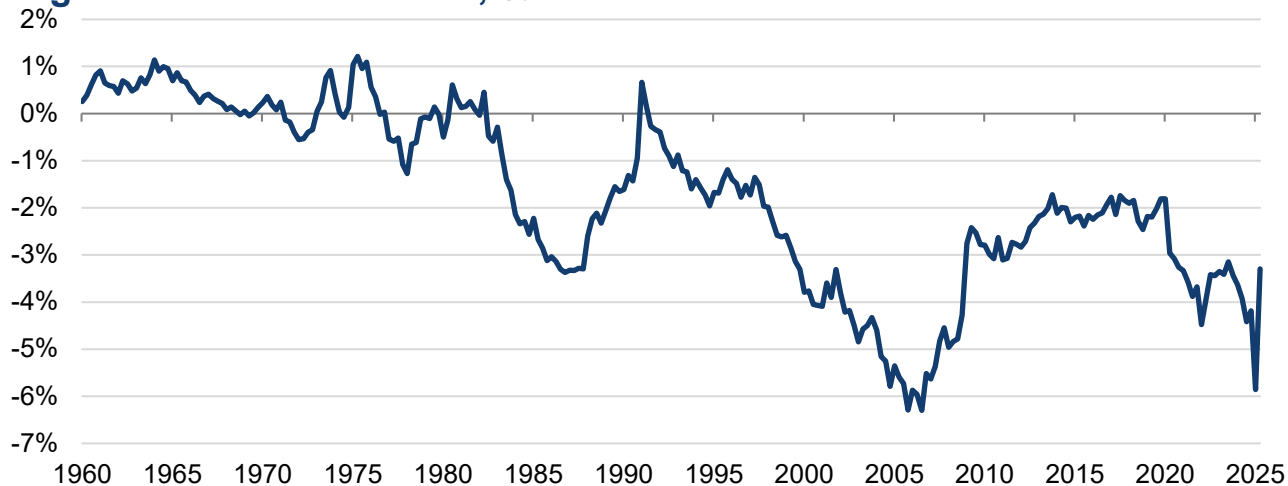
available data—of isolating the non-volatile components of FDI with a reasonable degree of accuracy; nor a sense of what portion of FDI is volatile.

CEA staff reiterates its assessment that the most reasonable approach for determining BOP deficits using modern BOP reporting is the balance of the current account. Nevertheless, any attempt to recreate the basic balance today would include—at most—the current-account balance, the capital-account balance (which will be small in comparison), and net FDI.¹⁶ No other components of the financial account should be included, as they are highly liquid and can exhibit volatile behavior. Accordingly, including those components would contravene what the basic balance was attempting to measure. Indeed, a more expansive definition would necessarily require arbitrary judgment—a key reason that the basic balance was discontinued by the BEA in the first place.

Recent Balance-of-Payment Trends in the United States

Figure 1 below shows the current-account balance as a share of GDP since 1960. The current account has been in a persistent deficit since the 1990s. Moreover, relative to the overall economy, the current-account deficit was larger at the end of 2024 (-4.1% of GDP; also -4.1% of GNP) than at its trough in the early 1970s (-0.7% of GNP in 1972, see Figure 2), according to data estimates available when Congress passed Section 122 of the Trade Act of 1974.^{17,18,19}

Figure 1: Current Account, % of GDP



Source: Bureau of Economic Analysis; CEA calculations

¹⁶ Indeed, the IMF routinely uses the current account to assess a country's balance-of-payments position since 2012 the IMF has published External Sector Reports that center primarily on staff assessments of current account imbalances and real exchange rates.

¹⁷ CEA staff believe that the end of 2024 offers the cleanest assessment of the current BOP for the purposes of Section 122 because it precedes dynamics associated with IEEPA tariffs announced and implemented in 2025.

¹⁸ Figure 3 uses GDP to measure overall economic activity, rather than GNP, as it is the more conventional metric now. However, GDP is a relatively modern measure, and in 1974 only GNP estimates were available.

¹⁹ Based on the latest-available estimates, the current-account balance was -0.5% of GDP in 1972.



Figure 2: Basic Balance & Current Account, % of GNP

Given data estimates as of 1974

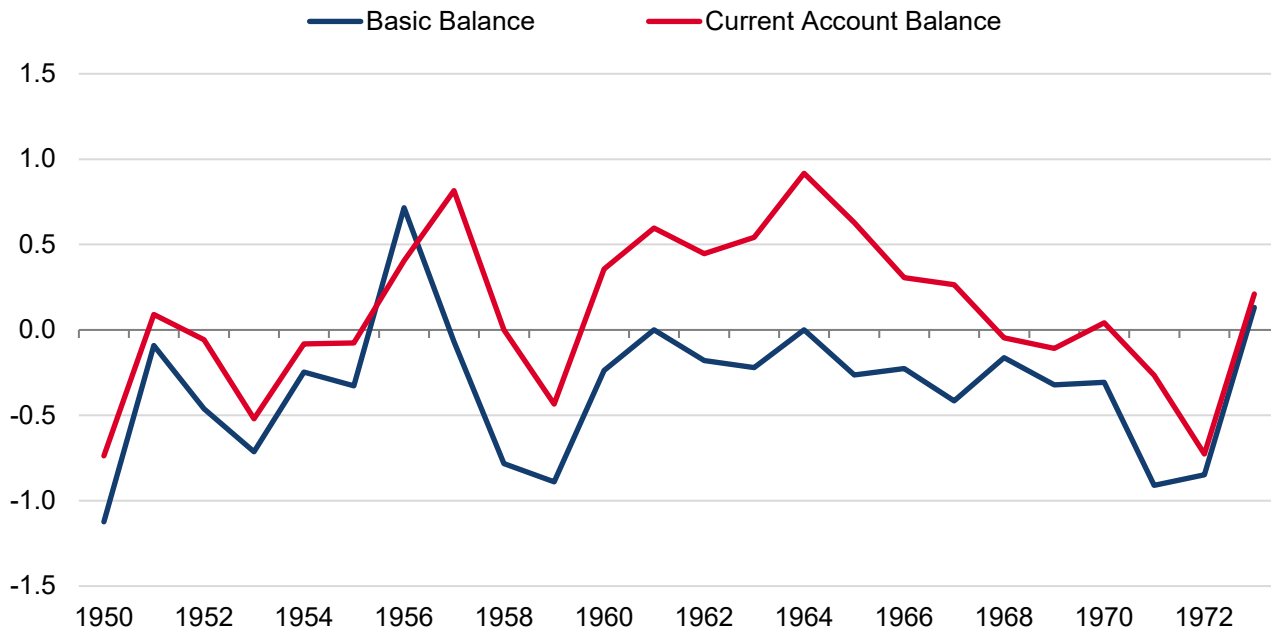
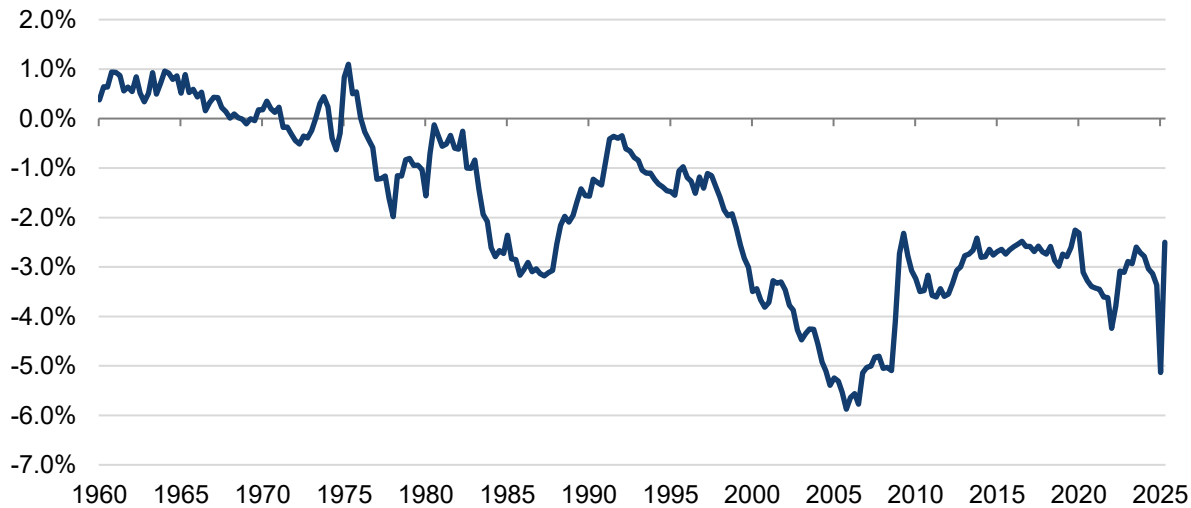


Figure 3 shows the U.S. trade balance (goods and services). The trade balance is by far the largest component of the current account, and tends to be the primary driver of fluctuations in the current balance. As a result, the time series behavior of the current account is dominated by the trade balance. The trade balance has been in persistent deficit since the 1970s. The annual United States goods trade deficit has grown by over 40 percent in the past 5 years alone, reaching \$1.2 trillion in 2024 and remaining at approximately \$1.2 trillion in 2025.



Figure 3: Trade Balance as Share (%) of GDP



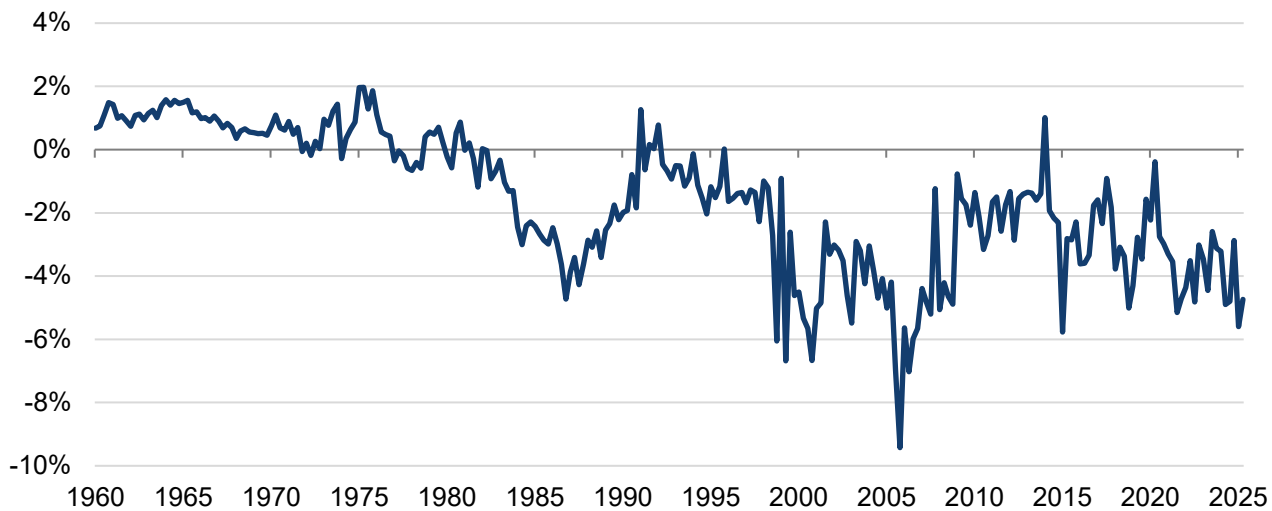
Source: Bureau of Economic Analysis; CEA calculations

Figure 4 shows CEA's most expansive candidate BOP deficit measure, capturing the original intent of the basic balance, the current account plus the capital account plus net FDI. This measure excludes most assets in the financial account, as in modern-day financial markets, such assets can exhibit high degrees of liquidity and volatile flows, akin to broad financial flow. However, even this measure is likely too inclusive. As acknowledged by the BEA in 1976, "even some components of direct investment[] can be quite volatile."²⁰ This suggests that a representation of the BOP deficit more aligned to the historical understanding of BOP deficits would reflect only the most durable components of FDI. As illustrated by Figure 4, CEA's most expansive candidate measure is more volatile than the current-account balance, but presents the same qualitative story: a prolonged period in deficit.

²⁰ June 1976 Survey of Current Business, Report of the Advisory Committee on the Presentation of Balance of Payments Statistics.



Figure 4: Current Account + Capital Account* + Net FDI, Share (%) of GDP



Source: Bureau of Economic Analysis; CEA calculations

*In July 1999, BEA restructured international transactions to separate the capital account from the financial account. Revised historical estimates are available beginning in the fourth quarter of 1989.

Appendix: Additional Measures Related to Balance-of-Payments Deficits/Surpluses

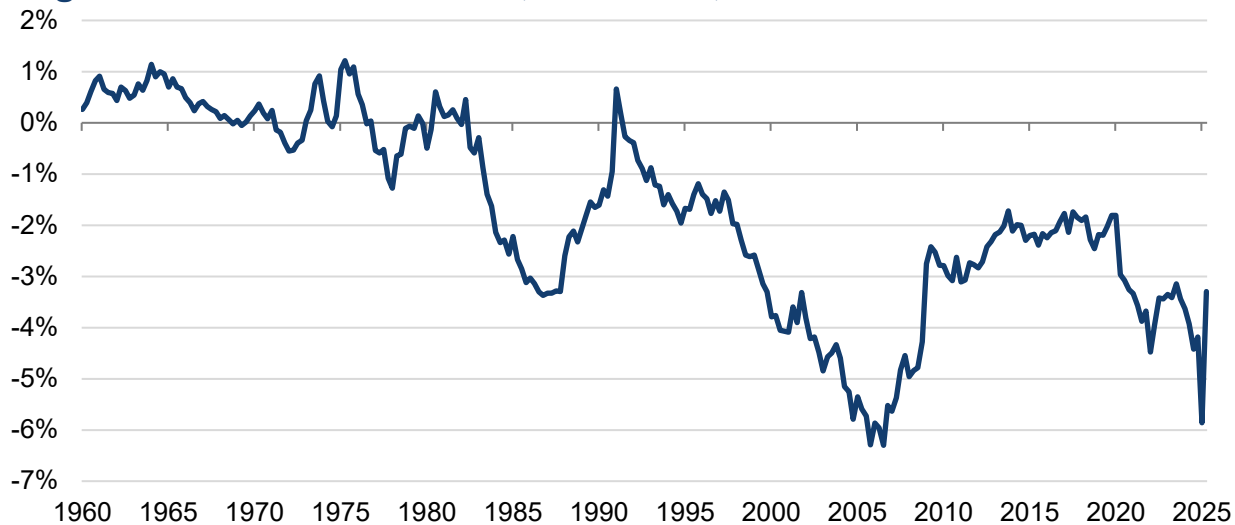
This appendix presents charts of BOP-related measures sequentially in terms of the measures' generally-agreed-upon levels of liquidity and volatility, from least to most liquid and money-like. The level of liquidity is important because a BOP deficit can be thought of as the excess surplus/demand for payment instruments and other liquid money-like claims, securities, or reserves. The BOP-related measures included in the charts are (1) the current account, (2) the capital account and FDI, (3) equities, and (4) long-dated non-federal-government issued portfolio assets (debt instruments). While equities and debt instruments were included in the measure of basic balance in the 1970s, CEA staff believe that, given developments in financial markets, such financial instruments should be more appropriately thought of as payment instruments than as long-term capital. CEA staff note that all four of these measures are currently in deficit.

Current Account Balance



For reference, Figure A-1 replicates Figure 2, the current-account balance as a percent of GDP since 1960.

Figure A-1: Current Account, % of GDP, 1960Q1-2025Q2



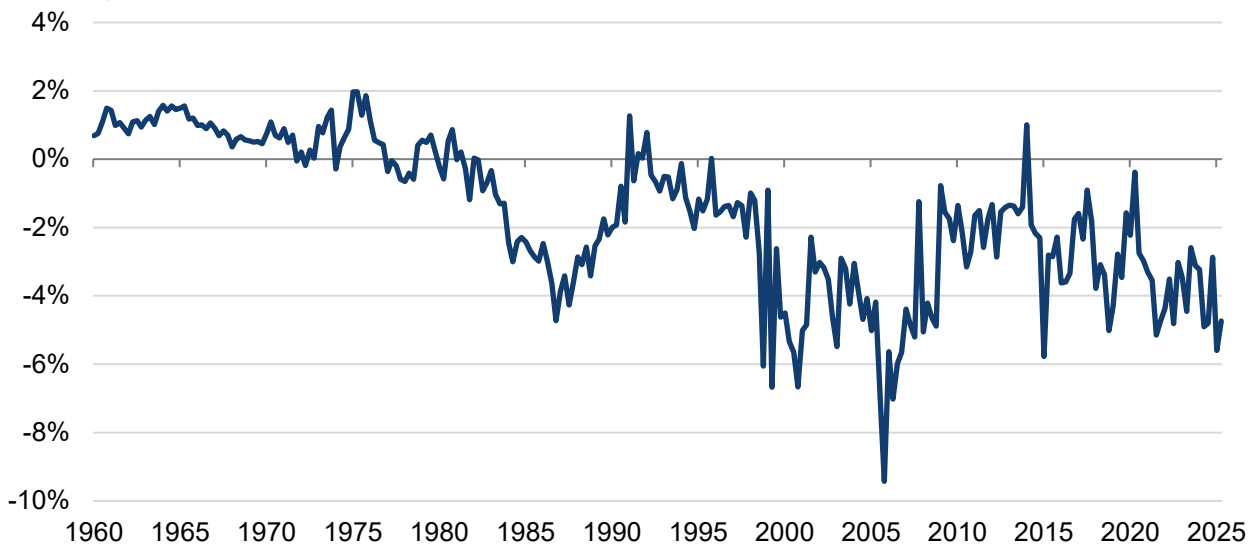
Source: Bureau of Economic Analysis; CEA calculations

Current Account + Capital Account + FDI

For reference, Figure A-2 replicates Figure 3, the combination of the current account, capital account, and FDI balances as a percent of GDP since 1960. This is the CEA's most expansive BOP measure that remains plausibly within the spirit of the original "basic balance" in the context of today's financial markets.



Figure A-2: Current Account + Capital Account* + Net FDI, % of GDP, 1960Q1-2025Q2



Source: Bureau of Economic Analysis; CEA calculations

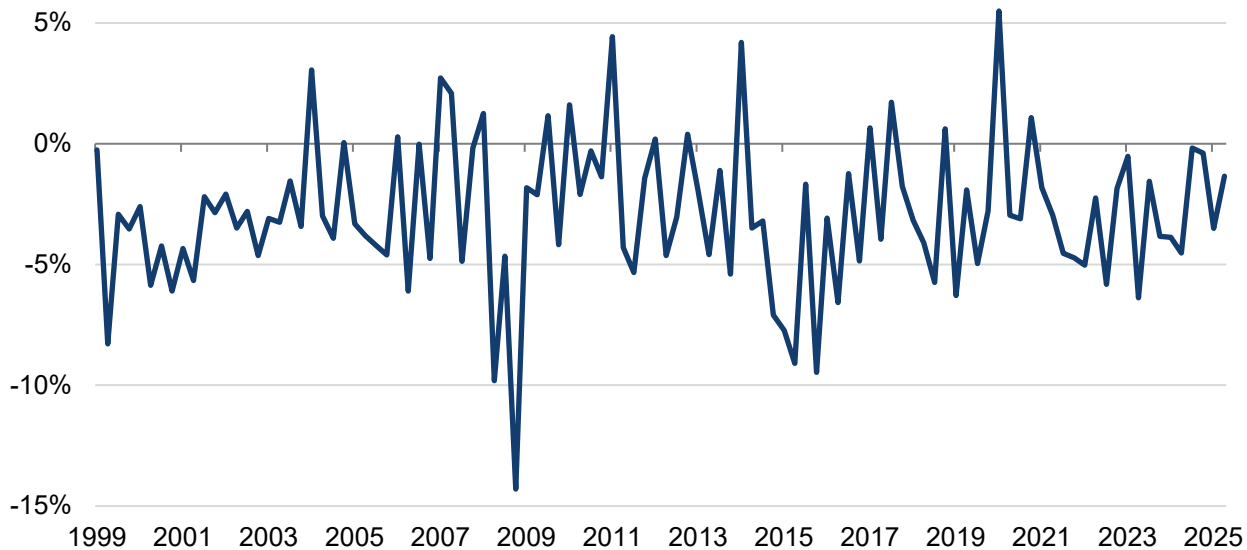
*In July 1999, BEA restructured international transactions to separate the capital account from the financial account. Revised historical estimates are available beginning in the fourth quarter of 1989.

Current Account + Capital Account + FDI + Equities

As equities are perpetual assets, they are not short-term. But equity investments are more liquid than FDI. Many equities can be quickly exchanged for cash, but can exhibit large short-term fluctuations in valuation making this asset class relatively less liquid and money-like than cash or many debt securities, like treasuries. Financial developments since the early 1970s have made this asset class much more liquid and money-like and therefore far less aligned with the original intent of the basic balance. Therefore, equities should not be included in measures intended to reflect the basic balance. Figure A-3 includes net equity flows from BEA, which include equity and investment fund shares in addition to loans, to the concepts included in Figure A-2. Data on the equity balance are unavailable prior to 1999.



Figure A-3: Current Account + Capital Account + Net FDI + Equities, % of GDP, 1999Q1-2025Q2



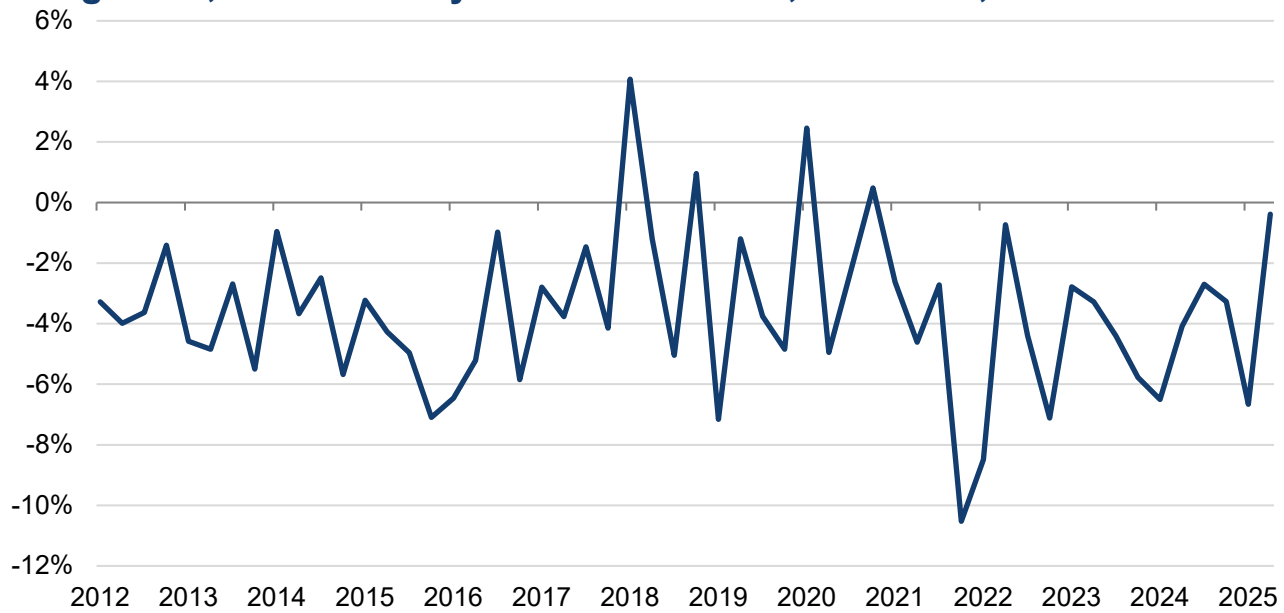
Source: Bureau of Economic Analysis; CEA calculations

Current Account + Capital Account + FDI + Equities + Long-Term Non-Treasury Debt Securities

The basic-balance measure used in the early 1970s also included some long-term debt securities. CEA attempted to map these historical series to their modern analogs. However, as with equities, financial developments since the early 1970s have made these instruments more liquid and money-like, and less aligned with the original intent of the basic balance. Further, the items included in the chart below are almost certainly more inclusive than the items originally included in the original basic balance. Figure A-4 includes long-term, non-Treasury debt instruments to the concepts included in Figure A-3. Data on long-term, non-Treasury debt instruments are unavailable prior to 2012.



Figure A-4: Current Account + Capital Account + Net FDI + Equities + Long-Term, Non-Treasury Debt Instruments, % of GDP, 1999Q1-



Source: Bureau of Economic Analysis; CEA calculations