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Basic Balance: A Desperate Attempt to Use an Old Statistic to Impose New Tariffs

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TOPLINE: The Trump Administration is attempting to use "basic balance" in court to retroactively defend the unlawful imposition of Sec. 122 tariffs. Their use of this figure has six major issues that are highlighted below.

BACKGROUND: After losing its case before the Court of International Trade (CIT) on whether it could use Sec. 122 to implement tariffs, the Trump Administration is attempting to retroactively save its case on appeal and avoid issuing roughly $22 billion in tariff refunds by leaning on a statistic known as "basic balance." This half-century extinct statistic intended to capture the long-run, stable, and durable flows of capital across the border, but was abandoned in 1976 because the government conceded that the statistic did not serve its intended purpose and could not be relied upon for policymaking. The Trump administration's analysis recognizes the statistic's futility, adding that, "it is today even less realistic and more arbitrary," than when it was abandoned 50 years ago. Yet, it nevertheless attempts to use the basic balance statistic to defend its unlawful tariffs. This report identifies the issues with the Administration's attempt to use an old concept to impose new damage on the American people.

Major Issues with the Administration's Use of Basic Balance:

1) **The Timing** - The administration's reliance on basic balance is a post hoc justification conjured up during litigation, not an initial reason for the tariffs.
2) **"Large and Serious"** - There is no "large and serious" balance of payments deficits, which are required by Sec. 122.
3) **Ability to Produce the Equation** – The original concept of basic balance cannot be accurately constructed today.
4) **Equation Fidelity** - The formula the Trump Admin is using as a stand in for basic balance is not an accurate representation of the original formula.
5) **Correct Purpose** – The Trump Administration's new approximation of basic balance does not serve the same core purpose as the original version and does not capture the same data about the current state of the economy.
6) **Pretext** – The new version of basic balance is clearly a backdoor attempt to substitute a current account deficit for a basic balance deficit in order to give the president tariff authorities under Sec. 122.

BOTTOM LINE: The Trump Administration is desperately and inappropriately using the defunct statistic "basic balance" in an attempt to not have to refund billions of dollars of inappropriately taken tariff revenues and to expand presidential power to impose new tariffs on the American public.

Full Report

Between February 24, 2026, and July 24, 2026, the Trump Administration imposed sweeping tariffs under Sec. 122. These tariffs were imposed unlawfully. Pending litigation aims to ensure that the improperly collected tariffs are refunded and that future Administrations will not similarly abuse this power. Because the CIT struck down the tariffs imposed under Sec. 122, the Administration is attempting to bring back a defunct statistic to justify the tariff imposition. If the tariffs are ultimately refunded, the Administration would owe back roughly $22 billion in Section 122 duties collected in 2026 (Tax Foundation, 2026).

The government's claim is that these tariffs were lawfully implemented pursuant to the following authority provided under Sec. 122 (19 USC 2132): "to deal with large and serious United States balance-of-payments deficits." The Administration claims that a so-called basic balance deficit can qualify as a "balance of payments" deficit for the purposes of Sec. 122.

Balance of payments (BOP) refers to the total flows of money into and out of the country. In short, this includes three basic components: the current account, the capital account, and the financial account. Together, they capture flows from current economic activity, such as trade and income flows, one-time transfers of capital, and the balance of lending and investments in future activities, respectively. By definition, these flows always balance and, under the modern system of free-floating currency exchange, do so without triggering a potential drawdown of government reserves or anything else resembling a crisis or serious issue.

However, the Trump Administration claimed that a subset of BOP, the current account, could be used as a proxy for the whole of BOP. This is akin to judging whether a household's budget is balanced by counting its rent or mortgage payment but ignoring its paycheck.

Unsurprisingly, the CIT sided against this novel and improper use of the current account as a proxy for the whole of BOP. In its decision, the CIT mentioned a statistic that has been defunct since 1976 called "basic balance." (Oregon v. United States, 2026) Basic balance was intended to capture the long-run, stable, and durable flows of capital across the border. It attempted to remove the short-term and highly volatile financial flows from the mix. It was abandoned by the government (as this report details below) because it proved unreliable at doing so.

There is no record of the government calculating, considering, or even mentioning basic balance as part of the initial imposition of Sec. 122 tariffs. Nevertheless, since the CIT mentioned this old statistic, on appeal the Trump Administration has seized on this basic balance statistic to justify the Sec. 122 tariffs. In July, the White House Council of Economic Advisers (CEA) published a paper attempting to reproduce the statistic and the government's new appeals filing leans on this paper to make the case for using the concept to justify its tariffs. This paper was produced months after the imposition of these tariffs, after a loss at the CIT, and after the CIT mentioned the concept of "basic balance."

Problems with the Government's Use of Basic Balance

The validity of the government's use of this new basic balance measure rests on several incorrect foundations that this report will examine:

1. **Timing** - That the government considered and utilized the concept of basic balance when issuing these tariffs.
2. **"Large and Serious"** - That there exists "large and serious" BOP deficits.
3. **Ability to Produce the Equation** - That the concept of basic balance from the 1970s can be accurately constructed today.
4. **Equation Fidelity** - That the formula presented by the government is an accurate representation of the formula used in the 1970s.
5. **Correct Purpose** - That CEA's new approximation of basic balance can serve the same core purpose as the version of basic balance it presents as having been used in 1970s.
6. **Pretext** – That this new version of basic balance is anything other than a backdoor attempt to simply use a current account deficit in place of basic balance.

This report aims to show that the government's current argument fails in each of these six ways and that the new version of basic balance advanced by the government does not support its imposition of impose Sec. 122 tariffs.

1) Timing of the Administration's Appeal to Basic Balance

The government's new filing leans on basic balance as a proxy for overall balance of payments. However, basic balance did not appear in the tariff proclamation nor in the Administration's initial defense of the proclamation. Further, the specific definition of basic balance that the government is using seems to have originated with a White House Council of Economic Advisers (CEA) paper, entitled *Measuring Balance of Payments Deficits*, that was published in July of 2026, several months after the Sec. 122 tariff proclamation was issued and about two months after the CIT decision. It was the CIT, in its initial ruling, that introduced the concept of basic balance into this dispute. (Oregon v. United States, 2026) The government cannot credibly claim that it considered basic balance when it imposed these tariffs, much less that it rested its Sec. 122 authority on that consideration.

2) A Large and Serious Issue with the Government's Argument

To lawfully implement tariffs under Sec. 122, one of three specific conditions must be met. The one upon which the Trump Administration relied requires the presence of "large and serious" balance of payments deficits. Though these terms necessitate some discretion in implementation, , any thorough and good-faith analysis would find that U.S. balance of payments has neither a large nor serious deficit.

Even the current CEA acknowledges that the balance of payments flows must balance, meaning a deficit of precisely zero. In its own words: "Under the BOP accounting framework, the balance of payments (as an accounting identity) must balance." (CEA, 2026, p. 2)

Sec. 122 was drafted against the collapse of the Bretton Woods system, to address a problem that floating exchange rates ultimately resolved. Under the previous system, a currency value imbalance could force the U.S. government to transfer gold reserves abroad. This was the BOP deficit that Sec. 122 was created to potentially address. Under the current unpegged system, the exchange rate of the dollar automatically addresses any imbalance without triggering a serious issue and without requiring the federal government to take any action (including drawing down gold or any other reserve) to maintain an arbitrary pegged dollar value.

The current account deficit, the CEA's preferred and arbitrary substitute for balance of payments, has improved substantially over the last twenty years. The current account deficit decreased from 6.3% of GDP 20 years ago to 3.1% today. (FRED, n.d.) Over the same timeframe, real per capita GDP has increased by roughly 29% while per capita household and nonprofit net worth has increased by roughly 55%. (FRED, n.d.; BEA, n.d.) Contrary to some contemporary political messaging, America has not been selling off net worth to finance trade or any other imbalance. Even if CEA's tortured definition of a BOP deficit is passable, the resulting deficit is not serious: it draws down no reserves, triggers no currency crisis, and depletes no national wealth. The notion that there are large and serious BOP deficits is not backed up by the real-world data. On this point alone, the Sec. 122 tariff impositions were unlawful.

3) Ability to Accurately Produce Basic Balance

The government admits that the true concept of basic balance cannot be produced with modern datasets and that the measure is no longer faithful to the original concept.

The CEA paper contains a section titled: "Why the Basic Balance Was Abandoned and Cannot Be Perfectly Reconstructed" admitting that the core concept cannot be replicated. The government admits that basic balance relies on two things that are not possible to ascertain: 1) a distinguishable gap between structural and speculative flows and 2) on being able to differentiate across investments that will ultimately be held for short or long periods.[1] In fact, the CEA paper clearly says that:

> *These problems have grown immeasurably worse since…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.* (CEA, 2026, p. 4)

Despite these acknowledgements, the CEA paper goes on to make an approximation of basic balance.

4) Equation Fidelity

The CEA paper describes both the basic balance equation and what it is supposed to reflect: "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." (CEA, 2026, p. 3) In its recent filing, the government summarizes the value of basic balance as serving to "capture only durable trends." (Brief for Appellants, 2026)

CEA draws its understanding of basic balance from a cited 1975 New York Fed paper entitled *Measuring the United States Balance of Payments*, written by Patricia Hagan Kuwayama. (Kuwayama, 1975) In that paper, she defines the included long-term capital items as "(1) United States Government capital, (2) direct investments by United States corporations abroad and by foreign corporations in the United States, (3) private portfolio investments, and (4) all long-term private loans, defined as those whose original maturity from time of issuance to maturity exceeds one year."

[1] Council of Economic Advisers (2026, pp. 3–4). "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 therefore cannot be identified with the true motivation of the flow. 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.' 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."

However, the CEA paper's approximation of basic balance does not truly attempt to reconstruct the aforementioned long-term capital figure in the 1975 paper it cites. Instead, their new equation is clearly just a rough subset of the standard BOP equation.

BOP is defined as the current account+capital account-financial account (CA+KA-FA). This equation captures, respectively, current trade and income flows, one-time transfers of capital, and investment flows. Together, they capture the total balance of payments. CEA's approximation of basic balance is merely the first two components plus Net Foreign Direct Investment (FDI) in place of FA, to produce (CA+KA-FDI). FDI is largely a subset of investment flows that are captured in the broader BOP equation. Therefore, their new version of basic balance fails to capture the one thing that distinguished basic balance from BOP in the first place: the long-term capital items that the government cites in Kuwayama's 1975 paper. Only the second of Kuwayama's four capital items is even partially included in the new CEA basic balance equation. CEA's appendix considers additional components, but even those do not capture Kuwayama's full set. As such, the Administration's new version of basic balance does not mathematically reflect what it claims the measure captures.

5) Purpose of Basic Balance

Beyond the mechanical construction of the basic balance equation, the CEA paper also proposes an intended purpose for the basic balance statistic. As quoted above: "The basic balance…[is intended] to isolate the persistent, structural component of a country's external position from short term or speculative financial movements." (CEA, 2026, p. 3) As noted above, the government's recent filing summarizes the value of basic balance as serving to "capture only durable trends." (Brief for Appellants, 2026)

Even if basic balance could be reconstructed or mathematically approximated, this new version of the basic balance statistic would still need to capture and reflect the original intent of basic balance. If it cannot, then the government's argument fails and the attempt to use this new version of basic balance would not suffice to justify the imposition of Sec. 122 tariffs.

In particular, the purpose of basic balance is, in the words of both CEA and the government's filing, to "isolate the persistent, structural component of a country's external position from short term or speculative financial movements" or to "capture only durable trends." (CEA, 2026, p. 3; Brief for Appellants, 2026) This is related to the concept of long-term capital, capital that will reliably be held for long periods of time, where volatility is limited.

Later in the same paper, CEA admits that "CEA staff have no credible way—and are aware of no credible way, given currently 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, 2026, pp. 5–6) If, as CEA admits, there is no credible way to isolate out non-volatile parts of FDI, then their arbitrary choice of that variable (FDI in place of the financial account) does not shift the standard BOP equation toward isolating the robust and stable flows that basic balance is intended to capture.

In fact, Kuwayama's perspective (in the paper CEA cites) further undermines the government's case. She writes "direct investment is measured in part by the flow of funds between parent and overseas affiliates within a multinational firm, and it therefore reflects all kinds of short-run changes in financing patterns." She goes on to say that other seemingly long-term investments are often used for speculative investments and are distorted by short-term trends.[2]

The conclusion of her paper casts even more doubt on the alleged utility of basic balance as a proxy for BOP. She states that for the purpose of separating stable flows from volatile flows, basic balance is the ideal but "that none of the usual approximations of this balance can be recommended with any enthusiasm." (Kuwayama, 1975, p. 194) She recommends "[p]erhaps all that should be attempted is to add the current-account and United States Government capital items together, since they are the only measured flow categories that can be regarded as largely interest insensitive." (Kuwayama, 1975, p. 194)

Moreover, the CEA misrepresents Kuwayama by saying that "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." (CEA, 2026, p. 5) This inaccurately employs the 1975 paper to support its new equation that includes the modern capital account but not the U.S. government capital items that Kuwayama discusses.

Ultimately, Kuwayama's paper concludes with: "The search in our present statistics for a reliable net basic balance that will consistently illuminate the underlying balance-of-payments situation of the United States is doomed to disappointment." (Kuwayama, 1975, p. 194) As already mentioned, the July CEA paper affirms her conclusion: "These problems have grown immeasurably worse since." (CEA, 2026, p. 4)

[2] Kuwayama (1975, p. 187). "These intracorporate transactions are as interest sensitive as any liquid capital flows, and they may also be distorted by tax considerations and various accounting practices of the multinational firms. An examination of the behavior of the United States direct investment account during periods of exchange market speculation easily reveals how important this distortion of the basic balance can be. In addition, to these problems in the direct investment account, international portfolio flows can also be seriously distorted by short-term fluctuations. In fact, investment in foreign securities has sometimes been an important vehicle for currency speculation."

6) A Trojan Horse for the Current Account

When compared with the standard equation for BOP (CA+KA-FA) the government's new basic balance definition swaps out the financial account (FA) for FDI. FDI is the arbitrary variable that the CEA inserted into the equation to produce its new proxy measure of BOP. In short, substituting a measure that is largely a subset of BOP for actual BOP guarantees a gap between the two by arbitrary construction, not by merit.

Whereas the original basic balance equation attempted to legitimately capture and clarify the difference between stable and volatile capital flows, CEA's measure is a cherry-picked equation engineered to produce a gap. CEA then points to that gap as evidence that although basic balance cannot be fully reproduced today, the current account is a serviceable approximation of it. This is exactly what the CIT already ruled against: using the current account as a proxy for BOP to justify the imposition of Sec. 122 tariffs.

The advisory committee that retired basic balance in 1976 anticipated precisely this problem. Its report, in reference to basic balance and a few other balances to be retired, stated: "[T]he members of the Committee agreed that, as a general principle, any balance which is recognized as being seriously deficient should not be published, and that a multiplicity of flawed balances would tend to cause public confusion and disenchantment with the presentation of the data." (Advisory Committee, 1976, p. 22) The Committee retained the trade and current account "partial balances," but added that "[t]he Committee further recommends that the two balances to be retained be relegated to memorandum status in order to reduce the emphasis placed on these balances as summary indicators of the U.S. international transactions." (Advisory Committee, 1976, p. 22) The Committee's caution maps directly onto this dispute: it warned against treating a partial balance as a summary of U.S. international transactions; which is precisely what the Administration now proposes and upon which it rests its case.

Conclusion

The six issues raised in this report defeat the government's use of basic balance to invoke Sec. 122 and impose new tariffs on the American people. The statutory predicate fails at the threshold. There is no large and serious balance of payments deficit, and for that reason alone the tariffs were unlawful. The rest of the government's argument fails on its own terms, measured against its own materials and the sources it cites. Basic balance formed no part of the original decision to impose these tariffs. The Administration concedes that the 1970s measure cannot be reconstructed with modern data. Its substitute formula makes no attempt to capture the long-term capital items that defined basic balance in the first place. It concedes further that the substitute cannot isolate the stable, durable flows the original was built to isolate. What remains is a vehicle for doing precisely what the CIT has already rejected: treating the current account as a stand-in for the balance of payments. The Sec. 122 tariffs imposed this year were unlawful and should be refunded. The government's new basic balance statistic does not change this reality.

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