

**Study Questions**  
(*with Answers*)

**Lecture 12**  
**Trade Balance**

**Part 1: Multiple Choice**

Select the **best** answer of those given.

1. Which of the following **would** be included as contributing **positively** to the U.S. balance of merchandise trade?
  - a. Purchase by a U.S. airline of an airplane made by the European firm, Airbus.
  - b. Sale of a U.S. Treasury bill to a Japanese bank.
  - c. Sale by a U.S. airline, to an Italian student, of a ticket from Rome to New York.
  - d. Purchase by the Russian government of wheat from a U.S. grain firm.
  - e. A capital export in the form of construction of a foreign factory by a U.S. firm.

*Ans: d*

2. The United States in 2011 and 2014 (the years for which international transactions were reported in the text) had a surplus in its
  - a. Balance on merchandise (goods) trade.
  - b. Balance on goods and services.
  - c. Balance on current account.
  - d. Balance on financial account.
  - e. None of the above.

*Ans: d*

3. If all international transactions were included and measured accurately, then the statistical discrepancy would be
  - a. Zero.
  - b. Short-term capital flows only.
  - c. Positive only if the central bank intervened to support the currency.
  - d. Negative if the country were running a trade deficit.
  - e. \$742 million.

*Ans: a*

4. Which of the following would **not** be included as contributing **negatively** to the U.S. balance of trade on goods and services?
- Purchase of stock in an Egyptian corporation by a retired school teacher in Flint, Michigan.
  - Purchase of a case of French wine by a member of the Arizona Highway Patrol.
  - Sale of an insurance policy by the British Firm, Lloyds of London, to the city council of Lubbock, Texas.
  - Sale of 1.4 tons of ripe tomatoes by a Mexican farmer to members of a fraternity at the University of Michigan.
  - The hiring of a Canadian trucking company by a U.S. firm to transport horseradish into Canada.

*Ans: a*

5. A surplus in the balance of trade or in the balance on current account (assume they're the same for this question) implies that
- The country's volume of employment is expanding.
  - The country is spending on goods and services more than it is earning from producing them.
  - The country is lending to foreigners more than foreigners are lending to it.
  - The country is accumulating reserves of foreign currency.
  - The country's economy is healthy.

*Ans: c*

6. The textbook reports the US current account with a deficit that became smaller from 2005 to 2009, then rose a bit in 2010 and 2011. What has happened to it since then?
- The deficit has turned to a surplus.
  - The deficit fell further in 2012 and 2013.
  - The deficit has remained more or less unchanged.
  - The deficit has grown, but more slowly than before 2005.
  - The deficit has grown faster than before 2005.

*Ans: c (See graphs in lecture)*

7. What policy does Warren Buffett suggest in order to eliminate the U.S. trade deficit?
- Stop trading with China.
  - Devalue the dollar.
  - Issue Import Certificates to exporters, to be used by importers.
  - Require that countries wishing to export to us use Special Drawing Rights.
  - Make outsourcing of jobs illegal.

*Ans: c*

8. Mankiw compares the US trade deficit and the US rate of unemployment in 2006 and 2010. What does he find.
- The trade deficit was higher in 2010 when unemployment was higher.
  - The trade deficit was lower in 2010 when unemployment was higher.
  - The trade deficit was lower in 2010 when unemployment was lower.
  - The trade deficit was higher in 2010 when unemployment was lower.
  - Nothing, because the trade deficit and unemployment are unrelated.

*Ans: b*

9. What does Obstfeld say determines a country's bilateral deficits and surpluses?
- Whether the other country that we trade with is trading fairly.
  - How productive each country's firms are producing manufactures.
  - The size of US tariffs compared to the other country's tariffs.
  - The international division of labor based on each country's comparative advantage.
  - Exchange rates.

*Ans: d*

## **Part II: Short Answer**

Answer in the space provided.

1. Define the following terms:

- Current account      *Ans: A record of transactions in goods, services, investment income, and unilateral transfers between residents of a country and the rest of the world.*
- Trade balance      *Ans: The value of a country's exports minus the value of its imports.*

- c. Official reserve assets      *Ans: Holdings by governments and central banks of assets – primarily foreign currencies but also gold and SDRs – for use in settling international debts and intervening in the exchange market.*
- d. Odious debt      *Ans: Debt incurred without the consent of the people and that was not used for their benefit. (see Gerber)*

2. Identify the following transactions by whether they belong in the U.S. current account or financial account, positively (contributing to a surplus in that account) or negatively. Put a plus or a minus sign in the appropriate column.

	Current Account	Financial Account
a. A U.S. farmer sells a truckload of artichokes to a Canadian restaurant.	+	
b. A German professor is paid royalties on a textbook published by a Boston publishing firm.	–	
c. A student in Thailand deposits dollars in a Los Angeles bank account, planning later to pay tuition at UCLA.		+
d. The owner of a pizza chain in Kansas sends \$1000 to relatives in Sicily.	–	
e. An American company buys a warehouse in Ireland.		–
f. AT&T pays dividends to holders of its stock in Brazil.	–	
g. A Brazilian widow buys stock in AT&T.		+
h. A Michigan student, preparing for a semester abroad in France, buys \$1000 worth of French currency.		–

3. Suppose that the following symbols represent the values of the economic variables indicated, in a country with no government:

$Y$  = National Income = GDP

$C$  = Consumption

$S$  = Saving

$I$  = Investment

$X$  = Exports

$M$  = Imports

$B$  = Borrowing by domestic residents from abroad

$L$  = Lending by domestic residents to abroad

Assuming if necessary that any other international transactions not mentioned here are zero, define the following in terms of these variables:

- a. GDP

*Ans:*  $Y = C + I + X - M$

- b. Saving (in terms of income and consumption)

*Ans:*  $S = Y - C$

- c. The Balance of Trade, BT

*Ans:*  $BT = X - M$

- d. The Balance on Financial Account, BF

*Ans:*  $BF = B - L$

- e. Use what you have written to show the relationship between saving, investment, and the trade balance.

*Ans:*  $S = Y - C = (C + I + X - M) - C = I + X - M = I + BT$   
*Thus*  $BT = S - I$

- f. Using the accounting identity that  $BT + BF = 0$ , show how saving and investment are related to international borrowing and lending. That is, derive an expression for  $S - I$  in terms of  $L$  and  $B$ .

*Ans:* *From*  $BT + BF = 0$ , *it follows that*  $BT = -BF$   
*Therefore, using the result of parts (e) and (d),*  
 $S - I = BT = -BF = L - B$