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.
   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 2008 (the year 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.
4. Which of the following would not be included as contributing negatively to the U.S. balance of trade on goods and services?
   
   a. Purchase of stock in an Egyptian corporation by a retired school teacher in Flint, Michigan.
   b. Purchase of a case of French wine by a member of the Arizona Highway Patrol.
   c. Sale of an insurance policy by the British Firm, Lloyds of London, to the city council of Lubbock, Texas.
   d. Sale of 1.4 tons of ripe tomatoes by a Mexican farmer to members of a fraternity at the University of Michigan.
   e. 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
   
   a. The country’s volume of employment is expanding.
   b. The country is spending on goods and services more than it is earning from producing them.
   c. The country is lending to foreigners more than foreigners are lending to it.
   d. The country is accumulating reserves of foreign currency.
   e. 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 2008. What has happened to it since then?
   
   a. The deficit has turned to a surplus.
   b. The deficit fell further in 2009, then rose.
   c. The deficit has remained approximately unchanged.
   d. The deficit has grown, but more slowly than before 2005.
   e. The deficit has grown faster than before 2005.

   Ans: b (See graphs in lecture)
7. What policy does Warren Buffett suggest in order to eliminate the U.S. trade deficit?
   a. Stop trading with China.
   b. Devalue the dollar.
   c. Issue Import Certificates to exporters, to be used by importers.
   d. Require that countries wishing to export to us use Special Drawing Rights.
   e. Make outsourcing of jobs illegal.

   Ans:  

Part II: Short Answer

Answer in the space provided.

1. Define the following terms:

   a. 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.
   b. 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.

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Current Account</th>
<th>Financial Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. A U.S. farmer sells a truckload of artichokes to a Canadian restaurant.</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>b. A German professor is paid royalties on a textbook published by a Boston publishing firm.</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>c. A student in Thailand deposits dollars in a Los Angeles bank account, planning later to pay tuition at UCLA.</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>d. The owner of a pizza chain in Kansas sends $1000 to relatives in Sicily.</td>
<td>–</td>
<td></td>
</tr>
</tbody>
</table>
3. Suppose that the following symbols represent the values of the economic variables indicated, in a country with no government:

\[
\begin{align*}
Y &= \text{National Income} = \text{GDP} \\
C &= \text{Consumption} \\
S &= \text{Saving} \\
I &= \text{Investment} \\
X &= \text{Exports} \\
M &= \text{Imports} \\
B &= \text{Borrowing by domestic residents from abroad} \\
L &= \text{Lending by domestic residents to abroad}
\end{align*}
\]

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

a. GDP
  \[\text{Ans: } Y = C + I + X - M\]

b. Saving (in terms of income and consumption)
   \[\text{Ans: } S = Y - C\]

c. The Balance of Trade, BT
   \[\text{Ans: } BT = X - M\]

d. The Balance on Financial Account, BF
   \[\text{Ans: } BF = B - L\]

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),

\[ S - I = BT = -BF = L - B \]