

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 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.

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 2008. What has happened to it since then?
- The deficit has turned to a surplus.
 - The deficit fell further in 2009, then rose.
 - The deficit has remained approximately unchanged.
 - The deficit has grown, but more slowly than before 2005.
 - 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?
- 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

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.*
- 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.*
- 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 from an Ann Arbor bank.		—

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.

$$\begin{aligned} \text{Ans: } \quad S &= Y - C \\ &= (C + I + X - M) - C \\ &= I + X - M \\ &= I + BT \end{aligned}$$

$$\text{Thus } BT = S - I$$

- 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 .

$$\begin{aligned} \text{Ans: } \quad &\text{From } BT + BF = 0, \text{ it follows that } BT = -BF \\ &\text{Therefore, using the result of parts (e) and (d),} \\ &S - I = BT = -BF = L - B \end{aligned}$$