

Study Questions

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.
2. The United States in 2011 (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.
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.
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.
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?
 - a. The deficit has turned to a surplus.
 - b. The deficit fell further in 2012 and 2013.
 - c. The deficit has remained more or less unchanged.
 - d. The deficit has grown, but more slowly than before 2005.
 - e. The deficit has grown faster than before 2005.
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.

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.

Part II: Short Answer

Answer in the space provided.

1. Define the following terms:
- Current account
 - Trade balance
 - Official reserve assets
 - Odious debt
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
- b. Saving (in terms of income and consumption)
- c. The Balance of Trade, BT
- d. The Balance on Financial Account, BF
- e. Use what you have written to show the relationship between saving, investment, and the trade balance.

- 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 .