# 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?

   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 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.

   *Ans:* *c (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: c*

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

   *Ans: b*

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

   *Ans: d*

## 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.

| | | 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),*
    $S - I = BT = -BF = L - B$