Chapter 24 Exercises

Self-Check Questions

1. If foreign investors buy more U.S. stocks and bonds, how would that show up in the current account balance?
2. If the trade deficit of the United States increases, how is the current account balance affected?
3. State whether each of the following events involves a financial flow into or out of the Mexican economy:
   a. Mexico imports services from Japan.
   b. Mexico exports goods to Canada.
   c. U.S. investors receive a return from past financial investments in Mexico.
4. In what way does comparing a country's exports to GDP reflect how globalized it is?
5. In 2021, Canada's GDP was \$1.991 trillion and its exports were \$631 billion. What was Canada's exports-to-GDP ratio?
6. The GDP for the United States was \$23.0 trillion in 2021, and its current account balance was –\$821.6 billion. What percentage of GDP was the current account balance?
7. Why do the trade balance and the current account balance track so closely together over time?
8. Explain the relationship between a current account deficit or surplus and the flow of funds.
9. What determines the size of a country's trade deficit?
10. If domestic investment increases, and there is no change in the amount of private and public saving, what must happen to the size of the trade deficit?
11. Why does a recession cause a trade deficit to increase?
12. For each of the following, indicate which type of government spending would or would not justify a budget deficit. Explain your reasoning.
    a. Increased federal spending on Medicare
    b. Increased spending on education
    c. Increased spending on the space program
    d. Increased spending on airports and air traffic control
13. How did large trade deficits hurt several East Asian countries in the mid-1990s? (Recall that trade deficits are equivalent to inflows of financial capital from abroad.)
14. Explain briefly whether each of the following would be more likely to lead to a higher level or greater imbalance of trade for an economy.
    a. Being an especially large country
    b. Having a domestic investment rate much higher than the domestic savings rate
    c. Having many other large economies geographically nearby
    d. Having an especially large budget deficit
    e. Being a country with a tradition of strong protectionist legislation that shuts out imports

Review Questions

15. If imports exceed exports, is there a trade deficit or a trade surplus? What about if exports exceed imports?

16. What is included in the current account balance?

17. In recent decades, has the U.S. trade balance usually been in deficit, surplus, or balanced?

18. Does a trade surplus mean an overall inflow or outflow of financial capital to an economy? What about a trade deficit?

19. What are the two main sides of the national saving and investment identity?

20. What are the main components of the national saving and investment identity?

21. When is a trade deficit likely to work out well for an economy? When is it likely to work out poorly?

22. Does a trade surplus help guarantee strong economic growth?

23. What three factors will determine whether a nation has a higher or lower share of trade relative to its GDP?

24. What is the difference between trade deficits and balance of trade?

Critical Thinking Questions

25. From time to time, a government official will argue that a country should strive for both a trade surplus and a healthy inflow of capital from abroad. Explain why such a statement is economically impossible.

26. Suppose a government official announces that the country wishes to eliminate its trade deficit but will strongly encourage financial investment from foreign firms. Explain why such a statement is contradictory.

27. If a country is a big exporter, is it more exposed to global financial crises?

28. If countries reduce trade barriers, would the international flows of money increase?

29. Is it better for a country to be an international lender or borrower?

30. Many think that the size of a trade deficit is due to a lack of competitiveness of domestic sectors, such as automobiles. Explain why this is not true.

31. If you observed a country with a rapidly growing trade surplus over a period of a year or so, would you be more likely to believe that the economy of that country was in a period of recession or rapid growth? Explain.

32. Which is more important, a country's current account balance or the growth of GDP? Why?

33. Will nations that are more involved in foreign trade tend to have higher trade imbalances or lower trade imbalances, or is the pattern unpredictable?

34. Some economists warn that the persistent trade deficits and negative current account balances that the United States has run will be a problem in the long run. Do you agree? Explain your answer.

Problems

35. In 2001, the economy of the United Kingdom exported goods worth £192 billion and services worth another £77 billion. It imported goods worth £225 billion and services worth £66 billion. Receipts of income from abroad were £140 billion, while income payments going abroad were £131 billion. Government transfers from the United Kingdom to the rest of the world were £23 billion, while various UK government agencies received payments of £16 billion from the rest of the world.

- **a.** Calculate the UK merchandise trade deficit for 2001.
- **b.** Calculate the current account balance for 2001.

36. Imagine that the U.S. economy has a government budget deficit of $100 billion, total domestic savings of $1,500 billion, and total domestic physical capital investment of $1,600 billion. According to the national saving and investment identity, what will the current account balance be? What will the current account balance be if investment rises by $50 billion while the budget deficit and national savings remain the same?

37. The following table provides some hypothetical data on macroeconomic accounts for three countries represented by A, B, and C and measured in billions of currency units. Private saving is S, tax revenue is T, government spending is G, and investment spending is I.

	Country A	Country B	Country C
S	700	500	600
T	0	500	500
G	600	350	650
I	800	400	450

- **a.** Calculate the trade balance ($M - X$) for each country.
- **b.** State whether each country has a trade surplus or deficit (or balanced trade).
- **c.** State whether each country is a net lender or borrower internationally and explain.

38. Imagine that in Germany, the government budget has a surplus of 1% of Germany's GDP, private saving is 20% of GDP, and physical investment is 18% of GDP.

- **a.** Based on the national saving and investment identity, what is the current account balance?
- **b.** If the government budget surplus falls to zero, how will this affect the current account balance?