

## MACROECONOMICS AT WORK EXERCISE

### THE BALANCE OF TRADE

**REFERENCE:** ‘The Trade Gap: How Long Can It Go On?’ (by Peter Coy), *BusinessWeek*, 22 November 2004, pp. 72-3.

### CHAPTER RELEVANT TO THIS EXERCISE: 17

#### CONTEXT

The article refers to the balance of trade *in the US*, though the debate about this issue has some parallels with the Australian situation. The *balance of trade* measures the excess, or deficit, of *exports* of goods and services compared to *imports*. The balance of *trade* is a significant component of the overall balance with the rest of the world *on current account* – that is including the balance of investment income and transfers (e.g. aid) paid overseas. In the US (as in Australia) the deficit on current account – largely because of a *trade deficit* (or a ‘trade gap’) – is large and growing.

It is important to note that the concept under consideration is different to the balance of government revenue and expenditure, and hence whether the *government’s budget* is in surplus or deficit. The reason that the recent record of *budget deficits* and *trade deficits* are often spoken about in the same context (and have actually come to be referred to as the ‘twin deficits’) is that both are funded to a large extent by borrowing from overseas; and hence imply increasing foreign indebtedness. However, the focus in this article is the *trade deficit*.

Opinion is divided as to whether the large and growing trade deficit – which essentially means that the country is spending more money overseas (on imports) than it is receiving (for exports) – is *sustainable* (i.e. can be continued) or whether it must inevitably end in dire economic consequences for the domestic economy, the rate of economic growth, and macroeconomic variables such as the level of employment (and unemployment) and inflation.

#### QUESTIONS

1. What is the magnitude of the trade deficit?
2. Why does – and how can – the deficit keep on growing?

3. What are the arguments behind the suggestion that trade deficits can keep on growing without any adverse consequences?
4. What are the arguments behind the prediction that the trade imbalance will soon cause major economic problems? What are these predicted to be?
5. Explain the argument that the problem of the trade deficit will be self-correcting.
6. What is the balance of the argument – who is more likely to be right?