What Causes the Trade Balance

\[ D = I - S + (G-T) + (X-M) \]

\[ M - X \]

What Causes the Trade Balance

The Demand for Loans

We had a negative balance on current account of \(-480\) billion. To balance that, we must have a net capital flow into the US of \(-480\) billion. Of course there was a statistical discrepancy of 45 billion so maybe our demand for loans was \(-525\) billion. Whatever the number, we have to account for it.

What is causing the trade balance? Is it a bad thing?

The Algebra

\[ Y = C + I + G + (X-M) \]

\[ Y + M = C + I + G + X \]

What we have

What we can do

The Algebra

\[ Y = C + I + G + (X-M) \]

\[ Y = C + S + T \]

\[ S = I + (G - T) + (X - M) \]
What Causes the Trade Balance

The Final Equation

\[ S = I + (G - T) + (X - M) \]

The Government Surplus or Deficit

The Balance on Current Account

In sum, the trade balance and foreign investment go hand in hand.

Our Graph

\[ D = I - S + (G - T) + X - M \]

World Supply of Loans

\[ -(X - M) \text{ or } M - X \]
What Causes the Trade Balance

Our Graph

\[ D = I - S + (G-T) + X - M \]

In sum, the trade balance and foreign investment go hand in hand.

-\((X-M)\)

or

\(M-X\)

The $64 Question

D= I – S + (G-T)+X-M

In sum, the trade balance and foreign investment go hand in hand.

Which is the chicken?

Which is the egg?

In sum, the trade balance and foreign investment go hand in hand.

Which is the chicken?

Which is the egg?

Four Answers

a) We live beyond our means
b) The government deficit
c) End of Manufacturing
d) Investment Opportunities

(a) We live beyond our means

\( D = I - S + (G-T) + X - M \)

S

We consume too much and don’t save enough.

Just whose means are we living beyond?

- Doubtless the saving rate is low.
  - Stock markets
  - Housing

Just whose means are we living beyond?

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- Besides, just because A is profligate is no reason for B to be concerned
Just whose means are we living beyond?

- Doubtless the saving rate is low.
  - Stock markets
  - Housing
- Besides, just because A is profligate is no reason for B to be concerned
- And who is lending to the profligate?

(b) We run an enormous deficit

\[ D = I - S + (G-T) + X - M \]

The government spends more than it takes in.

(b) We run an enormous deficit

So why didn’t the trade deficit decline in the 1990’s?

The government spends more than it takes in.

On the other hand the deficit is going up now as budget deficits rise.

The government spends more than it takes in.

(c) No Jobs

No saving because we are wiping out our manufacturing base and eliminating chances to work and earn.

The Manufacturing Base

- Most manufacturing is moving offshore.
The Manufacturing Base

• Most manufacturing is moving offshore.
• No comparative advantage

People are sending us goods without expectation of being able to buy things from us?
– Then to the South
– Then Offshore

People are sending us goods without expectation of being able to buy things from us?
– Then to the South
– Then Offshore

Formally, if Mexicans ship us t-shirts they expect to use the money to purchase CDs. At some time.
– Then to the South
– Then Offshore

Where are we?

a) We live beyond our means
b) The government deficit
c) End of Manufacturing
d) Investment Opportunities
End

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