Economics Problem Set #4: USA BoP Answer Key

Here are some data for the US economy in 1999 (in $B):

GDP:	9206
Exports:	956
Imports:	1221
Current account balance:	-331

1. The US has run a chronic trade deficit for 20 years. How might you explain the discrepancy between the trade balance and the current account balance for 1999?

The current account balance exceeds the trade balance by (minus) $66B. This represent net payments to foreign owners of US assets.

2. Suppose the return on foreign-owned assets in the US is 10%. If the trade balance and the reserve account remain unchanged, calculate the change in the following year's current account balance.

It will rise by an additional $33B to $366B.

3. Suppose the value of the dollar against a composite of other currencies (Euro, yen, etc.) were to fall by 20% while the volume of US imports (measured in physical terms) were to rise by 50%. What would be the new level of imports?

Oops, this was a writing error — I meant to say "if the volume of imports were to fall". In that case, the answer would be $732.6B. (A good question would be, Why is question 3 as written illogical?)

4. Why is the amount of foreign exchange (at present) irrelevant to the US economic situation?

The US' foreign exchange is the same as its domestic exchange: dollars. As long as the rest of the world accepts payments from the US in dollars, we never have to run short of exchange.