1 response Db /5Relations

Each post should be one paragraph in length (75 words) and must be substantive in nature Do not simply state that it is a good or bad idea, specify why and be detailed in your explanation. Aside from assisting a classmate, the goal is to demonstrate your mastery of the concepts.

1 response 75 words and reference

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| *You will submit a minimum of 1 paragraphs for the week. At least three paragraphs will be included in your MAIN POST and one paragraph each for your two Interactive Replies.* | | |
|  |  |  |
| *1st Interactive Response* | *1 Paragraph* | *75 words* |

1. Select one story posted by participants, and critique them. Ask questions or provide advice that will improve the story.

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BUS610-1302C-01: Economics for the Global Manager

Unit 5 Discussion Board

July 2, 2013

Government Deficits

The balance of payments is made up of the current account and capital and financial account (Career Education Corporation [CEC], 2013). If there is a deficit in one account the other account must have a surplus. This is so because the balance of payments uses a double entry accounting system, where a debit form one account credits another account. The current account is composed of product imports and exports, services imports and exports (including transportation receipts and payments), income receipts and payments, and unilateral transfers (CEC, 2013). All other private and public transactions post to the capital and financial account.

**Current U.S. Deficit**

For the past twenty years or so, the U.S. has experienced an overall current account deficit; this is composed of a trade of merchandise deficit, trade of services surplus, and a deficit in unilateral transfers (CEC, 2013). However, remember that a deficit in this account means that there is a surplus in the capital and financial account. This surplus in the capital and financial account has offset the deficit in the current account (CEC, 2013). So, what does this deficit really mean? Well, the U.S. is not competitive in the trade of goods; rather, the U.S. is a net importer of merchandise. The U.S. is competitive in the trade of services. Also, the U.S. is not a recipient of foreign aid; rather, foreign trade payments have increased steadily.

A deficit in the current account could be good in some cases and bad in others. Sometimes a current account deficit could be an indicator of economic growth or a shift in demographics; in these cases, the current account deficit may not be so bad. However, there are other times where a deficit in the current account can be a signal of competitiveness issues, poor financial decision making on the government’s part; in either of these cases a deficit in the current account is definitely a bad thing.

Sometimes a deficit in the current account comes to be if the government increases its spending in order to turn the economy around (Thoma, 2011). In this case, the deficit is funding the efforts of the government to stabilize the economy. Deficits in the current account also help to fund schools, government backed loans, social welfare programs, and to better infrastructure. The current account would also fund government spending on wars, which the U.S. has been heavily involved in. When the government increases its spending, there could be an increase in confidence in the business outlook; this could cause increased business spending and an increase in output (Thoma, 2011). These are the good things that could come from a current account deficit.

However, the current account deficit can also have the opposite effect. If spending is too much or the deficit is too high, it could decrease confidence and, ultimately, spending and output could diminish (Thoma, 2011). This situation would also raise interest rates. When interest rates increase, the government competes in the private sector to gain some of this potential income, which ultimately increases interest rates and costs even more (Thoma, 2011). In the end, investment and output fall. This causes the economy to become stagnant or even contract. Another problem that could arise is inflation. Inflation would occur with a current account deficit if the government prints, or releases, more money in order to stimulate the economy or repay its own debts; thus, driving down the value of the dollar (Thoma, 2011).

The worst outcome could be that the current account deficit gets so large that the government becomes insolvent (Thoma, 2011). This means that the government is unable to pay its bills. This would only happen if the government predicted that the outcome of insolvency would be less severe than printing more money to repay its debts. However, I do not feel that the current U.S. deficit is a real problem. The U.S. has been experiencing a deficit for the following reasons: 1) transfer from a goods to a service economy, 2) economic downturn which increased government spending, and 3) a shift in demographics ( the aging of the baby boomer generation).

**Proposed Actions for U.S. Account Deficit**

Yes, the U.S. has a sizable current account deficit; yes it has grown considerably since the economic downturn in 2008. However, the current account deficit has also shrunk recently and is projected to continue to do so as the U.S. economy continues to heal (Frank, 2013). The U.S. government has increased current debts to finance the economic downturn; this was done to ensure that an economic depression was avoided. My personal advice would be to let the economy continue to grow on its own. In the words of Adam Smith in The Wealth of Nations the invisible hand will be more effective to move toward efficiency without government intervention (CEC, 2013).

Automatic adjustment mechanisms can be summed up as an automatic shift back to equilibrium after a currency shifts away from equilibrium (under fixed exchange rates) (CEC, 2013). How one feels that this will happen depends on the school of economic theory that they follow. Classical, Keynesian, and monetary theories all differ on how equilibrium will be reached. In classical theory, equilibrium will be reached via adjustments in price and interest rates; Keynesian theory postulates that adjustment will occur via income adjustments; and monetary theory states that monetary supply adjustments aid in reaching equilibrium (CEC, 2013).

**Current Account Deficit**

A current account deficit occurs when there is a combined balance of trade (in goods and services), income, and unilateral transfers that is negative (Bureau of Economic Analysis [BEA], 2013). This occurs when a nation becomes a net importer and lender of foreign aid. In other words, the nation is a net debtor. When this situation arises the government must find the funds to pay for its debt. This payment will either be taken from savings, or money will be printed. All of this and much more was involved in the discussion above related to the current U.S. deficit.

**Current Account Surplus**

Unlike the current account deficit, a current account surplus occurs when a nation has a positive balance of trade. A current account surplus means that the nation is a net creditor. A net creditor is a nation which supplying other nations with an wealth of goods and is to be paid money in return for the goods (Heakal, 2013). In other words, the nation with a current account surplus is funding the growth and productivity of other nations. This notion is known as funding the deficit (Heakal, 2013).

The early 1980’s was the last time that the U.S. saw a current account surplus. In fact, between 1981 and 1987, the U.S. current account balance shifted form a surplus of $5 billion to a deficit of $161 billion, which caused great concern (Stein, 2008). The loss within the current account was equal to a loss in the U.S. balance of trade on goods. This loss of balance of trade on goods was not accompanied with an increase in unemployment, however. Rather, employment grew by approximately 2.5% (Stein, 2008). How? Simple, this marked the transition of the U.S. being a major supplier of services, rather than goods.

In conclusion, a surplus in the current account would lead to a deficit in the capital and financial account and vice versa. The U.S. deficit is decreasing with the healing of the U.S. economy. In my opinion, this means that the government should allow the balance to correct itself. The U.S. has not had a surplus in the current account since the 1980’s. This was an event that was created by the transition of the U.S. from a manufacturing to a service and capital intensive economy.

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