

# The Power of Macroeconomics

## Lecture Ten:

Exchange Rates, The Balance of Payments, & Trade Deficits



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## The Purpose Of This Lesson

- Explain how exchange rates and international monetary system work.
- Illustrate how fiscal and monetary policies are used in a global economy.
- Examine the roots and scope of America's chronic trade deficit problem.

## Mirror, Mirror On the Wall

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- Who's the biggest debtor nation in the world?
- It's not some developing country like Brazil or Mexico.
- It's the good old U.S. of A.
- America has come full circle!
- In its infancy, the U.S. was a debtor nation.

## America's Debtor Nation Roots

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- From the revolutionary war to after the Civil War, the U.S. borrowed heavily from Europe.
- During World Wars I and II, America lent heavily to Europe as the debtor shoe was put on the other foot.

## America As a Creditor Nation

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- The U.S. greatly expanded its exports to Europe.
- After World Wars I and II, it lent large sums of money to the combatants for post-war relief.
- In the course of doing so, the U.S. became the world's largest **creditor** nation.

## America's Growing Foreign Debt

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### A Dangerous Trend

- Beginning in the early 1980s, America began running huge trade deficits.
- These trade deficits have led to an accumulated net foreign debt in the trillions of dollars.



## Is This A Problem?

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- To many, America's chronic *trade* deficits are as dangerous as chronic *budget* deficits.
- "Trade deficit hawks" warn that America is being forced to sell off its land and its factories -- and its future -- to finance these deficits.



## The Trade Deficit Doves

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- See trade deficits simply as an opportunity to buy inexpensive foreign goods and enjoy a higher standard of living.
- Argue that if foreign countries want to sell us cheap goods, we should buy and enjoy them, not erect protectionist trade barriers.



## **In This Lesson**

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- Examine the roots and scope of the trade deficit problem.
- Learn some “balance of payments” accounting.
- Describe how exchange rates work and how the international monetary system is structured.

## **Also In This Lesson**

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- Illustrate how domestic fiscal & monetary policies impact foreign capital markets & the trade deficit.
- Understand the important link between the budget and trade deficits.
- Understand why it is increasingly important for nations to coordinate their fiscal and monetary policies in a global economy.