Quora: Can A Trade Deficit Mean Growth?

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This is a heavily debated question in economics for the sole reason that it does not have one pinpoint answer—the short answer to this question is, it depends. But I'm not going to just leave you with that, let's see why trade deficits and economic growth can have a positive or negative correlation.

TRADE DEFICITS AND THE CURRENT ACCOUNT BALANCE

To start, a trade deficit is when a country imports more than it exports. This can arise in a number of different situations, which could be either when an economy is doing good or bad.

Venezuela, located in Latin America, enjoyed a relatively stable trade surplus of 10 billion from 2010 until 2014. However, the Socialist-led nation has recently been tossed into financial catastrophe, and since 2015, the country has seen a trade deficit of 1 billion, which is quickly falling due to the immense hyperinflation currently taking place in the country.

In Venezuela, their trade deficit has halted economic growth because the socialist government has to import everything from food to currency, because their Bolivar 100 ($10 US) collapsed in value and was deemed worthless. Thus, in this instance, a trade deficit was not beneficial to economic growth, but rather, social stability, and was necessary for Venezuela to survive during these difficult times.

Conversely, the United States owns the largest trade deficit by far, with a deficit being forecasted at $44.8 billion for the Month of May 2017. This imbalance amounts to over $7.3 trillion being accumulated over the past few decades.

To many, having a **NATIONAL DEBT IN THE TRILLIONS** does not sound like an adequate financial strategy, but for the USA, it is just that.

As stated by Daniel Griswold of the CATO Institute For Economic Research,

The U.S. trade deficit is the result of a net inflow of capital to the United States from the rest of the world. Because of our stable and relatively free domestic market, we remain the world's most

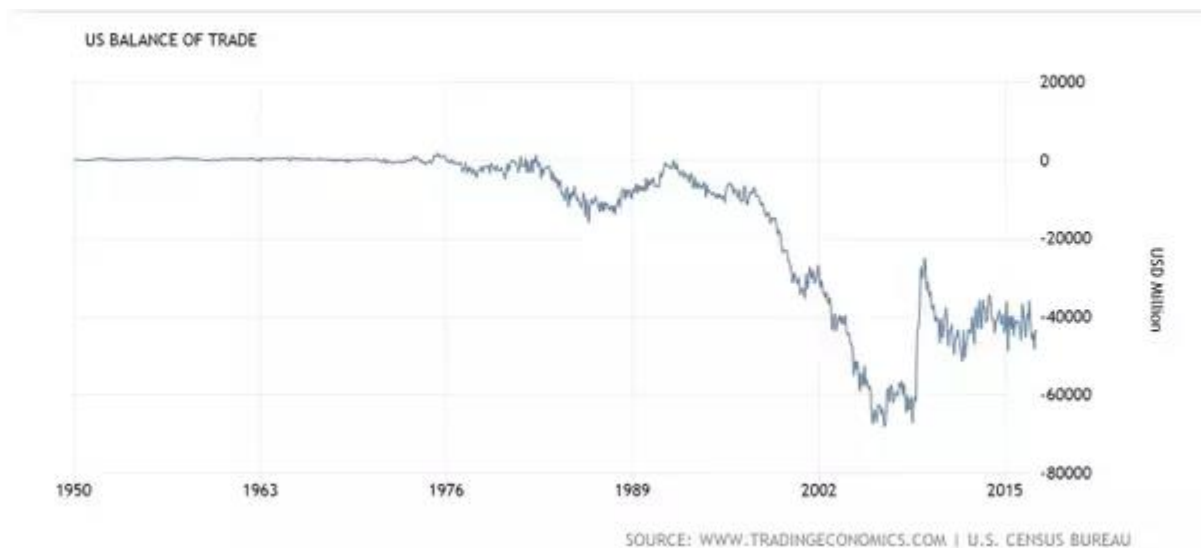
popular destination for foreign investment. We have become a net importer of capital because Americans do not save enough to finance all the available investment opportunities in our economy. This inflow of capital from abroad allows us to pay for imports over and above what we export.

In other words, the trade deficit is simply a mirror reflection of the larger macroeconomic reality that investment in the United States exceeds domestic savings. If we want to change the U.S. trade deficit we must change the rate at which Americans save and invest.

How do you increase saving you ask? That job goes to the Federal Reserve Banking system of the USA, which is responsible for setting interest rates. The higher the interest rate, the greater the saving in an economy.

To draw a picture in your head of how saving, consumption, and deficits work to impact economic growth, I'm going to show two graphs.

The first graph is the Balance of Trade in the USA since 1950. As you can see, the US has almost never seen a trade surplus because their economy imports more than it exports and incurs debt in the process, but this isn't necessarily a bad thing, and does not translate into negative economic growth, but rather, the opposite.



The second graph is the Funds rate issues by the US Federal Reserve. Notice how from 1980 until 2007 in both graphs, the Balance of trade and the Fed's Interest rate were both decreasing. A lower funds rate means more consumption and less saving, more consumption means more imports, and a greater trade deficit.

Economic theory suggests that persistent trade deficits will be detrimental to a nation's economic outlook by negatively impacting employment, growth, and devaluing its currency. The United States, as the world's largest deficit nation, has consistently proven these theories wrong. This may be due to the special status of the United States as the world's largest economy and the dollar as the world reserve currency.

However, many other countries, including Spain, the United Kingdom, Australia, Mexico, Turkey, and Brazil, also are experiencing deficits. Meanwhile, other countries export more than they import and enjoy trade surpluses. China, Russia and Japan all have large surpluses.

The correlation between a trade deficit and economic growth really depends on the type of economy you are evaluating, and the specific goals of that economy.

The US can run a trade deficit because it has a relatively strong labour force and a high GDP per capita, meaning consumers can pay off debt from consumption. Conversely, China runs a trade surplus because their economy is export-driven. They are the manufacturing powerhouse of the world, but at the same time, have lower wages, worker rights, and GDP per capita then the US.

Different economies have different goals, which is why it is difficult to apply any economic theory to every economy as a whole.

Smaller countries certainly have experienced the negative effects that trade deficits can bring over time. Proponents of free markets, however, insist that any negative effects of trade deficits will correct themselves over time through exchange rate adjustments and through competition leading to a change in what a country produces. Large trade deficits may simply reflect consumer preferences and may not really matter much at all in the long run.