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The Balance of Trade Equilibrium To Enhance World Economies and Living Standards: International Trade and Payment Equilibrium Series Article # 3

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**THE BALANCE OF TRADE EQUILIBRIUM
TO ENHANCE WORLD ECONOMIES AND LIVING STANDARDS**

**INTERNATIONAL TRADE AND PAYMENT EQUILIBRIUM SERIES
ARTICLE # 3**

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THE BALANCE OF TRADE EQUILIBRIUM TO ENHANCE WORLD ECONOMIES AND LIVING STANDARDS

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OBJECTIVES OF RESEARCH

The U.S. continues to face balance of trade deficits. There are several factors responsible for these deficits, as many techniques have been tried to alleviate them.

This research has the following objectives:

1. To present a state of international trade that I have named “the balance of trade equilibrium,” or “BTE.”
2. To explain the significance of the BTE model for bringing equilibrium to the U.S. world trade; strengthening its dollar, economy and industry; creating rewarding jobs for American; and enhance their standard of living.
3. To explain the role of the BTE model in making similar advantages available to other countries as well.
4. To explain the utmost significance of first establishing and ‘announcing’ numerical goals for the BTE in the U.S. international trade.
5. To educate Americans and its trading partners that the BTE model is beneficial to all.
6. To propose two new definitions of full employment of labor. The current definition of full employment of labor, based primarily on physical counting, is not relevant anymore.
7. To suggest the levels of trade surplus and deficits at which a country should become concerned.

INTRODUCTION

The U.S. had a \$125 billion current account balance of payment deficit in 1996. It jumped to a \$726 billion deficit in 2005 (Table 1). The export surplus countries use a large portion of their surplus dollars to buy U.S. government bonds—not U.S. goods and services. The U.S. government badly needs these ongoing foreign loans to run its domestic and other financial affairs.

Taking loans and paying them back is nothing new between trading partners. However, since the U.S. continues to import more than what it exports, the U.S., for all practical purposes, is unable to pay back its borrowings to its foreign creditors. Actually, the U.S. has to continue to take additional loans from foreign creditors in order to meet its escalating financial needs.

The U.S. trade deficit continues to multiply because U.S. policy makers believe that this situation is nothing but a temporary outcome of the theory of free trade, which, over the years, would be corrected by itself. Unfortunately, this vision of self-correction is nothing more than an illusion.

The premises on which Alfred Marshall (1949, 1961) developed his theory of a perfectly free market system don't exist today. As a matter of fact, these conditions did not exist during his time either. Nor do I think that they would materialize in the near future. In reality, international trade today is taking place under conditions that resemble what Chamberlin (1948) and Dewey (1969) described as monopolistic or imperfect competition.

The fundamental problem is that the U.S. fails to recognize that an escalating indebtedness to foreign countries is, in effect, a result of America's inability to pay back its creditors in a currency (i.e. goods and services) that is acceptable to such creditors. As a result, as the U.S. continues to import products, it also continues to offshore millions of its precious jobs.

THE LIMITS OF CONVENTIONAL SOLUTIONS

Several strategies have been suggested to help correct the American trade imbalance. However, these conventional strategies have proved incapable of correcting this unprecedented trade disparity.

The argument, that the American dollar should be devalued and certain foreign currencies (renminbi, or RMB, the Chinese currency, for example) be revalued in order to help America improve its trade imbalance, does not have much merit. The American trade balance has continued to worsen as the value of dollar continues to decline.

The devaluation of dollar, which sometimes can help America improve its international trade balance, is no longer helpful to it in its current trade situation.

Similarly, the conviction that if America would increase emphasis on teaching science, math, and engineering, it will help students become more innovative and creative, which in turn will help improve America's balance of trade. This belief, while valuable, requires a close examination.

First, it would take several years for people to complete their education, become innovative and productive, and help America to increase its exports and reduce its trade deficits. Secondly, what is the guarantee that once the new techniques to improve American exports and economy have been mastered, that they would stay in the U.S.?

More likely than not, such techniques will be used by the American companies in their overseas, cheaper locations.

Likewise, restricting imports through quotas and duties to solve the American balance of trade deficits, which is a method used widely throughout the world, is a mutually destructive method as well.

BTE MODEL: THE SOLUTION

So here is my solution, the “Balance of Trade Equilibrium” (BTE) model.

The “balance of trade equilibrium” (BTE) is defined as a situation when trading among different countries is such that the trading partners would generally remain debt free from one another over a reasonable number of years. In other words, the value of a country’s imports would be equal to the value of its exports.

The successful implementation of the BTE model depends upon two very simple yet very complex but doable premises: (1) Establishment of numerical goals for international trade equilibrium; and (2) educating various parties about its importance.

In order to put the BTE model into practice, trading partners will have to discuss, establish, and meet numerical goals for their exports and imports. Using this logic, the U.S. for example, should have exported \$726 billion dollars worth of more products in 2005 to bring its balance of trade deficit to zero (Table 1).

According to the Immigration and Naturalization Act of 1990, Sec. 203, an incremental capital of \$1 million has the potential to create 10 new full time jobs. Similarly, according to the United Arab Emirates economy minister, Sheikha Lubna al Qasimi, every billion dollars of foreign investment in the U.S. creates 10,000 new jobs (CNN 2006)).

Based on these expert opinions, had the U.S. followed the BTE model, then, theoretically speaking, it could have created millions of new jobs over the years—that is, 7.26 new million jobs in 2005, 4.75 million new jobs in 2002, and 2.14 million new jobs in 1998 and so on (Table 1).

The additional imports of goods and services by the dollar surplus countries—worth \$726 million in 2005 (Table 1), for example, would help them enrich their economy, jobs, and standard of living. Similarly, the incremental demand for American products so created would help America grow its economy, jobs and standard of living. **A dollar surplus country, such as China, should buy products it needs directly from**

the U.S., or from any other country, it prefers. Eventually, those other countries can use these dollars to buy products they need from the U.S.

What else they can do with the American currency?

Now imagine that the U. S. would use some of this incremental demand and capital (\$726 billion in 2005) to buy more products from foreign countries. The multiplier effect of the BTE model will be huge. It will help create a continuing stream of innovations, inventions, new skills, new resources, new methods, and new products. The productivity would increase. Customized mass production would become the norm. The corporate profits, employment, personal income, and the government coffers would soar.

The BTE approach would herald the dawn of a new economic dialogue and cultural shift that would be beneficial to all. Over the years, its benefits would be many times more than all the economic and social progress we have witnessed so far.

FULL EMPLOYMENT AND TRADE LEVELS: NEW DEFINITIONS

Today the utilization of labor capacity is expressed in terms of the number of people employed and unemployed. This definition is obsolete, erroneous, and unfair. It tends to suppress creativity and innovation—as it tends to lower standards of living and widens gap between the rich and the poor. Actually, the utilization of labor capacity should be expressed in terms of its “**potential to produce;**” not in terms of how many people have jobs. I, therefore, propose the following two new methods to define the utilization of labor capacity both of which are based on the potential of the labor.

First, at a national level, the full employment of a resource (labor, for example) should be defined as the stage where it can produce all that it can, with the help of other resources (technology, capital, management, land, etc.). Thus, the labor will be considered fully employed when it has reached its full productivity potential.

Secondly, the full employment of a resource (labor, for example) should be defined as when it has produced (with the support of other resources) the amount of output needed to provide a reasonable standard of living for everybody.

Let me hasten to clarify two important points here. One, there is no upper limit of individual income under the BTE model. Two, this model has no relationship with the concept of redistribution of wealth.

I also propose the following new definitions of the “desirable levels of international trade” in the context of the BTE model.

First, the levels of trade deficits at which a country must become concerned may be defined as those levels where the deficits are not created voluntarily, but are a result of the country's inability to export enough to pay for its imports.

Secondly, the levels of trade surpluses at which a country must become concerned may be defined as those levels where the surpluses, if they are not used to import more, would restrict improvement in its economy, jobs, and standard of living.

BTE MODEL: SO HOW IT IS DIFFERENT?

The role of demand and capital in improving American sales, jobs, standard of living, and the overall economy is a familiar topic. Emphasis on increasing exports and reducing imports is not new either. Neither is the concept of establishing quantitative goals.

However, to emphasize the utmost significance of establishing quantitative goals in order to achieve equilibrium in a country's exports and imports, to relate such equilibrium to improving economic growth, jobs, and standards of living all over the world, and to create a national (and international) awareness of the benefits of establishing such equilibrium—all parts of the BTE model—are new.

INITIATIVES FOR REALIZING BTE GOALS

The Most Important Initiative: Establishment of numerical goals for international trade equilibrium

The first thing the U.S. must do is to **make an announcement**—to itself and to the rest of the world—that, within the framework of free and fair trade, its mission is to bring parity between its imports and exports. This mission declaration doesn't necessarily have to be made by the U.S. government. Any person or entity can take on this mission. More the leaders, the better it is. The hundreds of related questions and answers would then begin to emerge.

The appreciation and implementation of the BTE model will be an evolutionary process, which, to rephrase Schumpeter, would be "lopsided, discontinuous, and disharmonious by nature..." (1939, Vol. I, p. 102). It would take years of deliberations and volumes of research to understand and harness its incalculable value.

Following the BTE model would be as simple, and as difficult, as waking up early in the morning, doing exercise, eating well, working smart, taking

care of family, helping the needy, and trying to be healthy and happy on a regular basis.

If it sounds too simplistic an example, then how about these equally unsophisticated small beginnings which led to some of the most monumental accomplishments: Grameen Bank and micro-financing, Bill Gates, a college dropout, and Microsoft, Ingvar Kamprad and IKEA, Larry Page and Sergey Brin and Google, and Jeff Taylor and Monster.com.

Or, how about Mahatma Gandhi's peaceful non-cooperation and the freedom of India; or Martin Luther King Jr.'s "Dream" and the civil rights movement; or John Kennedy's determination to land on the moon and the proud Americans strolling on the Earth's neighborly planet; or James Watt and his steam engine; or Thomas Edison and electricity.

You know, on a second thought, my original example of health and happiness is not less challenging either. And it is absolutely, definitely well within our reach.

Educational Initiatives for Trading Partners

America should vigorously help its trading partners understand that it is in "their" best interest—for the reasons presented below—to use these dollars (directly or indirectly) to buy American goods and services, sooner rather than later.

First, this would help them improve their agriculture and industry; infrastructure of roads, waterways, airports, tunnels, and bridges; and their educational and healthcare facilities, among others.

Second, they would earn a much higher rate of return (15-25 percent) building these assets in their countries, as compared to the meager returns they are getting by investing their dollars in the U.S. treasuries and bonds (the ten-year treasuries are currently paying about 4 percent). The multiplier effect of the differential advantage will be huge.

Third, eventually, they would have to spend those dollars—what else can they do with them?

Finally, since the value of dollar is declining over the years, those dollars could buy more U. S. products today than they can do so tomorrow.

Educational Initiatives at Home

It is not enough, as many people do, just to talk about the American companies closing their plants in the U.S.; opening new plants abroad, expanding their foreign facilities, and transferring their production of goods and services from home to abroad. In the name of equity and national interest, I strongly suggest that these same people also talk about how many and how often several American individuals and organizations are making successful efforts to get purchase orders and investments from abroad. These individuals and organizations, each one of them, can act as role models for the many others to follow.

There is a special need to educate the American companies the benefits of the BTE model. As it exists today, they are looking at their benefits from only one side of their international transaction. That is, they are happy to offshore jobs which reduce their cost of production, increase profits, enhance bonuses, and raise share prices. Unfortunately, they are missing a whole host of benefits that would become available to them if they follow the second arm of the BTE model. This would require them to make all the necessary efforts to convince the other countries to spend their dollar-surpluses to buy American products in return as soon as possible.

I would recommend the American business community to calculate the astronomical effect of the \$726 billion worth of incremental demand and capital associated with it (just in 2005; Table 1) on their corporate profits, share prices and personal bonuses.

CONCLUDING THOUGHTS

The American educational institutions, governmental bodies, labor organizations, business associations, consumer groups, and the media should have a regular discussion of the merits, limitations, and implementation of the BTE model. They should explore how America, using its current skills and strengths, can “import jobs” through new purchase orders from abroad, and through new foreign direct investment in America.

Finally, international institutions such as the World Bank, the International Monetary Fund, the United Nations Agency for Trade and Development, EEC, NAFTA, G-8, and all the rest should discuss the significance of the BTE model for the U.S. and the world.

Is there a better way?

TABLE 1
U.S. INTERNATIONAL TRANSACTIONS
(BILLIONS OF DOLLARS)

| Year | Negative Balance on Current Account (billions of \$) ¹ | Est. of New Jobs using the BTE Model (millions) |
|------|--|--|
| 1996 | 125 | 1.25 |
| 1997 | 141 | 1.41 |
| 1998 | 214 | 2.14 |
| 1999 | 300 | 3.00 |
| 2000 | 416 | 4.16 |
| 2001 | 389 | 3.89 |
| 2002 | 475 | 4.75 |
| 2003 | 520 | 5.20 |
| 2004 | 668 | 6.68 |
| 2005 | 726 | 7.26 |

Notes:

1. The new job estimates are based on the requirements and assumptions made in the Immigration and Naturalization Act (\$1 million, 10 full time jobs).
2. It is assumed that the deficit in a given year is wiped out in the same year.
3. The important role of time lag has not been considered in these estimates. It is, however, recognized that in real life it will take some time for the orders for exports to come in, people to be hired, and production to begin. However, in a continuous system of imports and exports, this does not affect the fundamental value of the BTE model in any significant manner

¹ U.S. Department of Commerce, International Economic Accounts, December 2005, February 2006.

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