

Trade Deficit

Trade deficit is said to take place when the imports done by a country exceed that of the exports done by a country in a fiscal year. The trade deficit is also termed as the negative balance of trade.

Trade deficit is a way of measuring the extent to which international trade is happening between the countries of the world.

Trade deficit can be calculated for different types and categories of goods and services and for international transactions such as current account, financial account and capital account.

Trade deficit is said to occur when there is a negative balance in an international transaction account. These international accounts like balance of payments keep a track of all the transactions of monetary nature between the residents and non residents.

Causes of Trade Deficit

The causes of trade deficit are discussed here

1. Trade deficit is caused when a country does not produce everything it needs and imports such products from other countries and pays import taxes. This is known as the current account deficit.
2. It can also occur when companies are involved in manufacturing of products in a foreign country. The raw materials required for manufacturing are regarded as exports while the finished goods are imported to the country and are regarded as imports.

Impact of Trade Deficit

These are some of the impacts of trade deficit.

1. It increases the standard of living initially as residents have access to large varieties of products.
2. If trade deficit persists then the government needs to find more foreign exchange in order to bridge the gap, which leads to weakening of the local currency.
3. A high trade deficit will make the necessity for finding investors of foreign origin to reduce the import export gap.
4. High trade deficit leads to jobs being outsourced to foreign countries as more imports lead to fewer job opportunities.

5. Demand for imported goods leads to decline in demand for local made goods, which leads to closing of factories and the associated job losses.

Advantages of Trade Deficit

Following are the advantages of having a trade deficit

1. It allows a country to consume more than its production capacities.
2. It helps nations to avoid any shortfall in goods.
3. It provides the countries with comparative advantage, when such countries are involved in trade, it is beneficial as a whole for increasing global wealth.
4. Trade deficit allows to generate more foreign direct investment

Disadvantages of Trade Deficit

Following are some of the disadvantages of trade deficit

1. It is harmful for a developing country as more imports lead to deflation and increase the fiscal deficit.
2. More jobs will be outsourced as domestic industries will shrink with less demand when demand for foreign goods increases.
3. In the form of attracting foreign investment due to trade deficit, the country may end up providing ownership of its resources and assets to the foreign country.
4. A higher trade deficit leads to decrease in the value of local currency