Economics 3921 International Finance

Review of the First Year Income/Expenditure Model.

You have the following information about an economy

$C=100+0.8*Y_d$	Consumption Expenditure Function
I = 130	Investment Expenditure
G = 200	Government Expenditure
X = 100	Exports
$IM = 100+0.2*Y_d$	Imports
$Y_d = Y-T$	Disposable Income (GDP – Taxes)
T = 0.05*Y	Tax Function

1, Translate each of the seven equations into every day language.

2. Find the equilibrium level of GDP.

3. What is the government's budgetary position (G-T)?

4. What is the current account (X-IM) position (surplus or deficit)?

5. How much saving is there? Is it sufficient to finance domestic private investment?(Find I-S)

6. Now suppose that Government Expenditure rises by 100. How is the government spending financed? (there are three sources of finance – increased taxes, increased borrowing from domestic household, increased borrowing from the rest of the world).

7. Instead of assuming Government Expenditure increased assume that autonomous imports increase by 100(IM = 200+0.2*Yd). How are the increased imports financed? Is the government deficit affected?

8. Finally, assume that the all information about the economy is as originally as provided except that I rises by 100 to 130. How does this change the way activities are financed?

Suppose we are looking at a two country world. The two countries are identical but interdependent. Interdependency arises because of international trade. One country's imports are the other countries exports. Thus the export function for country 1 is $X_1 = 100+0.2*Y_{d2}$. Explain in words. Try to solve for equilibrium in the two country world.