

EC 380: International Economic Issues
Instructor: P. Economides
Problem Set 4
Fall 2022
Due: 11:59 p.m. on Friday, Nov 25th

Setup

Answers must be submitted online through Canvas by the stated deadline (see above). Please prioritize posting your submission in PDF format.

Questions

Q1. Answer the following short questions:

1) Describe the current account, list and describe each of its three subcomponents. Describe one of these items in detail.

2) What type of activities does the capital account consist of?

3) Regarding the financial account, what subcomponents does this measure include?

4) How do the current, capital and financial accounts relate to one another when it comes to their numeric values?

5) Explain the reason why the balance of payments features a statistical discrepancy value.

Q2. Consider the following balance of payments for a given country.

ID	Description	Billions, USD
1.	Current Account Balance	1000
2.	Capital Account Balance	200
3.	Financial Account	-
3a.	Net acq of financial assets, excl financial der (increase/outflow (+))	470
3b.	Net inc of liabilities, excl financial der (increase/inflow (+))	-890
3c.	Net change in financial derivatives	-200
4.	Statistical Discrepancy	
5.	Memoranda	
5a.	Balance on current and capital accounts	
5b.	Balance on financial account	

1) In theory, what should the difference between items (5a.) and (5b.) be?

2) Report the associated value of item (5a). Show your workings.

3) Report the associated value of item (5b). Show your workings.

4) What is the measure of statistical discrepancy measured as in this case (4.)?

5) Would this country be considered a case of CA surplus or CA deficit?

Q3. Consider a case in which a given economy reports a GNP level of 5.4bn USD. The primary income net flows are worth 1.2bn, while secondary income transfers are worth 0.2bn.

1) What is the implied level of GDP under these circumstances? Note that primary income is associated with income flows for compensating employees whereas secondary income is associated with transfers of income.

2) Demonstrate how the current account surplus is present in the measure of GNP, starting from the equation listed below.

$$GNP = GDP + \text{Net Primary Income} + \text{Net Secondary Income}$$

Using GDP, consider the fact that consumption (C) is equal to 1.5bn, investment (I) is 1.8bn and the government runs a balanced budget and collects 0.4bn in revenue (G).

- 3) What is the value of **net** exports? Show your work.
- 4) What is the value of savings? Show your work.
- 5) Suppose there is a shock to the economy, and the government is forced to run a major budget deficit 1.2bn. What does this imply about the tax rate for the country?

- 6) Update your measure of GNP to reflect this change in the government budget balance. Show your workings. What is the percentage change in GNP?

Q4. Answer the following short questions regarding our second half of studies into the Balance of Payments.

- 1) National savings for a given country can be subdivided into two items: domestic investment and foreign investment. Why do we treat the current account measure as our value of foreign investment? Describe an example to illustrate your point.

- 2) If a country is labeled as a net borrower, what does this suggest about the value/sign of the current account balance?

- 3) Is the current account deficit a country may face necessarily a problem for that country?
In what ways is it a sign of strength?

- 4) Under what circumstances can a current account deficit become a signal of weakness for a given economy? Elaborate with reference to examples from our Financial Crisis lecture.

- 5) Suppose a given country maintains a highly unsustainable current account deficit and exhibits all the signs of a looming economic crash. Why might neighboring nations and those invested in said country be concerned about this matter?