Department of Economics
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Economics 170

International Macroeconomics

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Homework 1

Due January 18, 2007

1. Find the figures corresponding to the U.S. balance of payments components for 2006. Present your answer in a form similar to table 1.1 of the lecture notes. That is, show figures in both current dollars and as a percentage of GDP. [For current account and GDP data visit the Bureau of Economic Analysis' website, http://www.bea.doc.gov, and follow the respective links under the heading "interactive data"]

2. Describe how each of the following transactions affects the U.S. Balance of Payments. (Recall that each transaction gives rise to two entries in the Balance-of-Payments Accounts.)

   (a) An American university buys several park benches from Spain and pays with a $120,000 check.

   (b) Floyd Townsend, of Tampa Florida, buys 5,000.00 dollars worth of British Airlines stock from Citibank New York, paying with U.S. dollars.

   (c) A French consumer imports American blue jeans and pays with a check drawn on a U.S. bank in New York.

   (d) An American company sells a subsidiary in the United States and with the proceeds buys a French company.

   (e) A billionaire from Russia enters the United States on an immigrant visa (that is, upon entering the United States she becomes a permanent resident of the United States.) Her wealth in Russia is estimated to be about 2 billion U.S. dollars.

   (f) A group of American friends travels to Costa Rica and rents a vacation home for $2,500. They pay with a U.S. credit card.

   (g) The United States forgives debt of $500,000 to Nicaragua.

3. **Dark Matter**

   Read the attached article "America's Dark Materials" (*The Economist*, January 21, 2006). Suppose that, contrary to the argument of Messrs Hausmann and Sturzenegger, there is no dark matter in the U.S. net foreign asset position. Using the information given in the article and taking into account that foreign-owned assets in the United States were about 12.5 trillion dollars in 2004 and assuming an interest rate on U.S. assets of 2 percent, find the foreign interest rate that can explain the size of the observed U.S. net investment income in 2004.

4. Consider a two-period economy that has at the beginning of period 1 a net foreign asset position of -100. In period 1, the country runs a current account deficit of 5 percent of GDP, and GDP in both periods is 120. Assume the interest rate in periods 1 and 2 is 10 percent.

(a) Find the trade balance in period 1 (TB_1), the current account balance in period 1 (CA_1), and the country's net foreign asset position at the beginning of period 2 (B_1^*).

(b) Is the country living beyond its means? To answer this question find the country's current account balance in period 2 and the associated trade balance in period 2. Is this value for the trade balance feasible? [Hint: Keep in mind that the trade balance cannot exceed GDP.]

(c) Now assume that in period 1, the country runs instead a much larger current account deficit of 10 percent of GDP. Find the country's net foreign asset position at the end of period 1, B_1^*. Is the country living beyond its means? If so, show why.

5. Use question 4 and the concepts developed in class as a theoretical basis to provide a critical analysis of the attached article from the November 27, 2003 edition of the *The Economist* magazine.