

1. Derive the fundamental balance of payments identity from the definitions of national savings and national income.
2. Under what circumstances does international borrowing raise or lower a country's future consumption levels?
3. Suppose the US Congress were to implement a European style VAT (Value-added- Tax), which is a comprehensive tax on consumption.
 - a. Describe two distinct ways this could affect the US current account.
 - b. What would happen to the net foreign wealth of the US?
4. How might foreign capital inflows lower the quantity of domestic savings in the US?
5. Costa Rica is a small open economy facing a fixed world interest rate, and running a trade deficit. Will an increase in domestic savings in CR affect investment demand in CR?

Questions 6 –7: The year is 1850. We have a one-good economy, in which food is produced using land and labor. There are two countries, England and Australia. In England the land/labor ratio is 1/10 -- that is, there are 10 workers for every acre of arable (farm-able) land. In Australia, the land/labor ratio is 20/1. The technology for farming is the same in both places.

6. If there is no international mobility of labor...
 - a. Using the facts about land/labor ratios in each country, draw a bucket diagram showing the equilibrium allocation of labor between the two countries. Important hint: compare the height of the MPL curve in agriculture for the two countries.
 - b. What should be true about labor wages in the England v. Australia?
7. Allow international mobility of labor.
 - a. Is there an incentive for workers to migrate? If so, why, and in which direction?
 - b. Given your answer to (a), what happens to wages and land rents in the England and Australia?
 - c. Politically, who might you expect to favor or oppose migration in Australia?

Questions 8-10. We're back in 2008. The ratio of skilled/unskilled labor is higher in the US than in China. Pharmaceuticals use skilled labor intensively. Children's toys use unskilled labor intensively.

8. The difference in skilled/unskilled labor between the US and China creates an arbitrage opportunity. Describe three distinct ways to take advantage of that arbitrage opportunity.

9. Suppose that the US and China close the door to migration but allow trade in goods. In the move from autarky to free trade...

- a. In what good does the US have a comparative advantage?
- b. What should happen to the economy wide demand for skilled /unskilled labor in the US?
- c. What should happen to the use of skilled/unskilled labor in pharmaceuticals and in children's toys in the US?

10. Suppose pharmaceutical production can be separated into two stages: a skilled-labor intensive research & development stage, and an unskilled labor intensive production stage.

- a. Is there an incentive for the US to outsource one of these stages to China? If so, which?
- b. How does this affect economy wide demands for skilled / unskilled labor in the US?
- c. How does it affect the use of skilled/unskilled labor in the pharmaceutical industry in the US?