Exercise 8

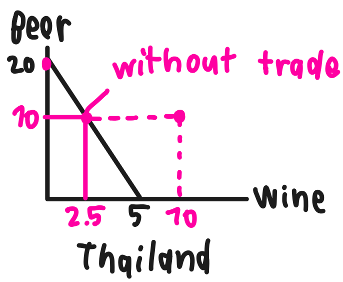
International Economics

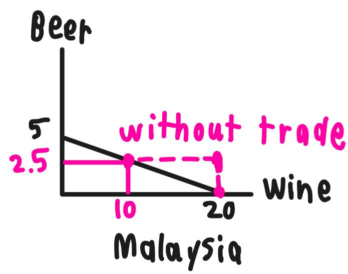
1. What is the difference between "absolute" and "comparative" advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

Absolute advantage is the advantage of one country when it uses fewer resourse to produce a goods more than other countries do.
Comparative advantage is the advantage of one country when it produces goods at lower opportunity cost than others.

2. The table below shows the amount of production that one worker in each country can produce. Assume that each country has 5 workers. **Draw a PPF and show** that both countries will benefit from trade.

	Thailand	Malaysia
Beer	4	1
Wine	1	4





Thailand has absolute advantage in beer while Malaysia has absolute advantage in wine.

After trade, TH gains more wine as a AA from trading with MAL.
After trade, MAL gains more beer as a AA from trading with TH.

∴ Both countries get benefit.

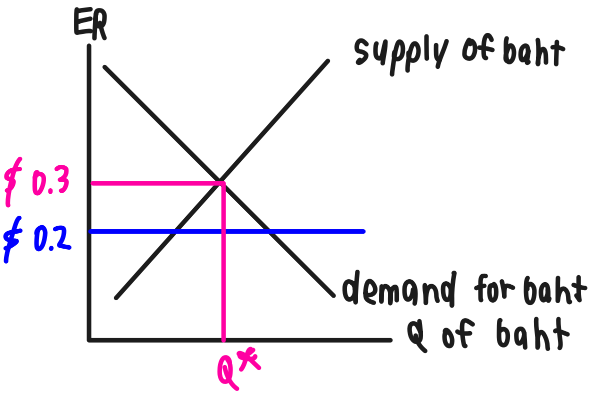
3. What do “current account surplus” and “capital account deficit” represent? What is the “Balance of Payment Identity”?

Current account surplus means we are export more than import, causing transfer surplus

Capital accout deficit means flowing out of country, it suggests nation increasing in ownership of foriegn asset. When they trade, each can enjoy 10 beer and 10 wine.

Balance of payment is a statement of all transaction made between agent & rest of the world over period of time.

4. Suppose the current market exchange rate is \$0.3 / 1 Baht. Use the foreign exchange market diagram to explain how the Central Bank of Thailand can “devalue” Thai baht to \$0.2 / 1 Baht under the fixed exchange rate regime.



The CB has to increase supply for baht. It can sell baht (buy USD) from foreign exchange market. This will lead to depreciation in Thai baht.

5. How does the floating exchange rate regime work? Under such regime, how does each of the following events affect Thai Baht (assumed to be a domestic currency)?

- The rest of the world imports more from Thailand. → appreciation in Thai baht
- More Thai investors invest abroad. → Depreciation in Thai baht
- Thailand will leave ASEAN (similar to the UK leaving the EU).

→ depreciation of THB

6. In the floating exchange rate regime, why might inflation cause a currency to appreciate and depreciate?

Because fisher equation when inflation increase, interest rate increase too. It attracts foreign investors to invest when foreign investors invest, they have more demand for Thai baht. It causes appreciation in Thai baht.

7. Suppose an iPhoneX is priced at 400 USD in the US and 300 GBP in the UK. Calculate the PPP exchange rate between USD and GBP.

$$\$400 = 300\ £$$
$$\$\ \frac{400}{300} = 1\ £$$
$$\$\ 1.33 = 1\ £\ (\text{PPP})$$
$$\$\ 1 = 1\ £\ (\text{ACTUAL EXCHANGE RATE})$$

8. Suppose the nominal exchange rate is 40 THB / 1 GBP. One apple costs 20 THB in Thailand, but costs 1 GBP in the UK. Calculate the real exchange rate.

$$RER = NER\ (THB/GBP) \times (PGBP/PTHB)$$
$$= (40/1) \times (1 \times 20) = 2$$

RER implies that, in term of purchasing power, ppl are willing to exchange 2 Thai apple w/GBP apple.

9. What assumptions are required for the Law of One Price to hold?

If cause of transportation is small, a price of same goods in different countries should be roughly the same.