

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?)

The main difference between absolute advantages and comparative advantages is

AA is focus on "specialization" doing

what they are good at the main implication is two countries with different specialization on trade and both will be benefit

CA is focus on the opportunity cost

and the main implication is some time

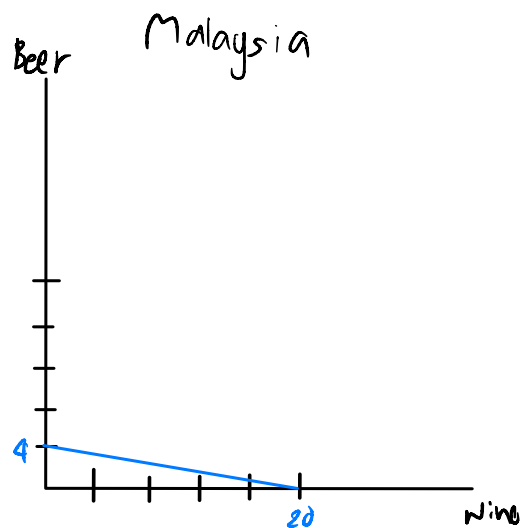
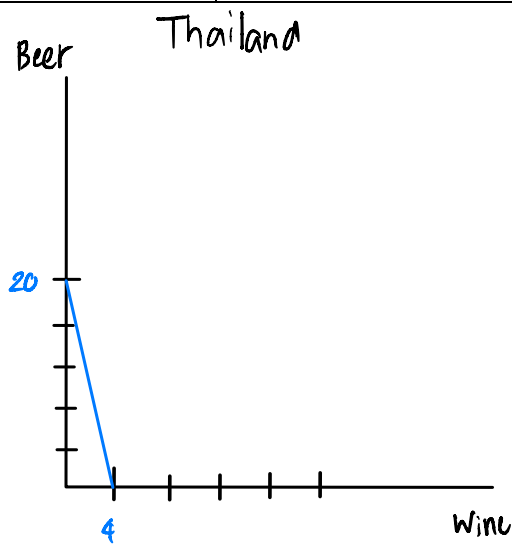
country doesn't have specialization but

both will still benefit from trade if

we look at the opportunity cost.

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



without trade

	Thailand	Malaysia
beer	8	5
wine	5	20

with specialization

	Thailand	Malaysia
beer	20	0
wine	0	20

with specialization + free trade

	Thailand	Malaysia
beer	10	10
wine	10	10

To conclude Thailand and Malaysia should produce on what they specialize and trade other product it will be benefit for both country

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

Current account surplus is when current account inflow more than current account outflow or when

export more than import (not always)

Current account

1. x-m

2. primary income

3. secondary income

Capital account deficit is when capital account

outflow more than inflow capital account

Capital account

1. direct investment / capital

2. portfolio investment

BoP Identity

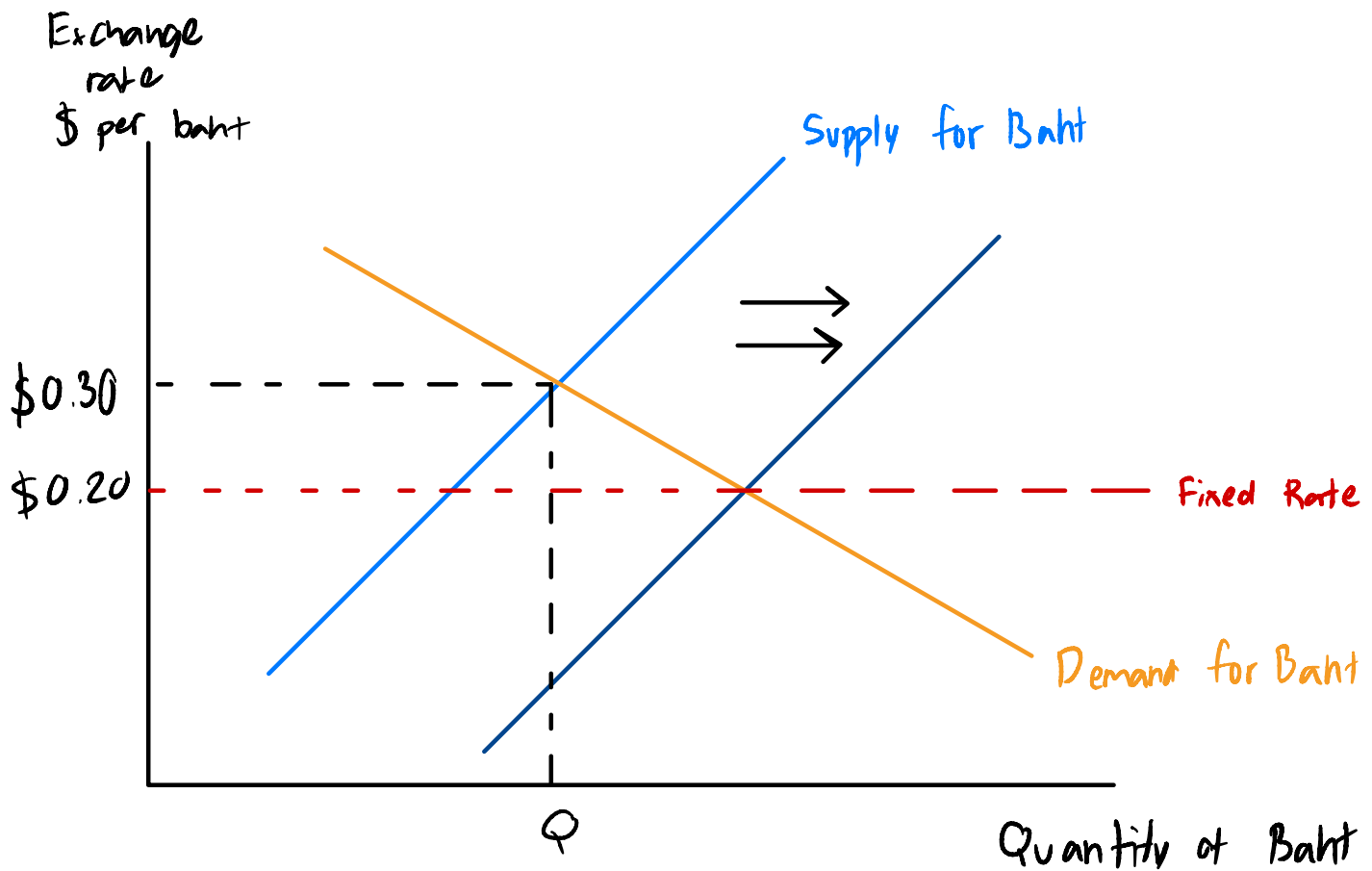
when we add current account and capital account

it need to be 0 and if CA is surplus

KA must be deficit and if CA is deficit

KA must be surplus: For Example CA = 5 KA need to be -5

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 central bank of Thailand can increase the supply of baht by sell baht and buy USD at the foreign exchange market This will devalue the THB.

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.

> mean more export in Thailand

> more demand of THB =

> THB appreciates

- More Thai investors invest abroad.

> less demand of THB

> THB depreciate

- Thailand will leave ASEAN (similar to the UK leaving the EU).

> less import and export

> less demand for THB

> THB depreciate

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

Appreciate

- From the Fisher's equation inflation increase interest rate so it attract foreign investor

Depreciates

- inflation make the good become more expensive so reducing export while raising import
- less purchasing power so make people want to hold currency decrease

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.

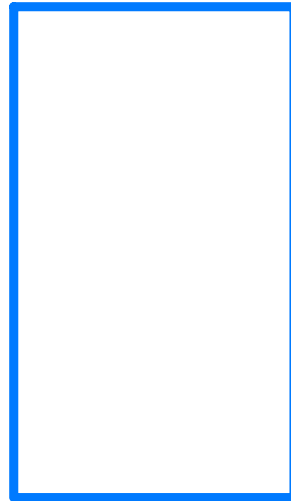
US



iPhone X

400 USD

UK



iPhone X

300 GBP

$$400 : 300$$

$$4 : 3$$

$$1.\overline{33} \text{ USD} : 1 \text{ GBP}$$

Purchasing power
parity 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.

$$\text{Real Exchange Rate (THB / UK)} = \frac{40}{1} \times \frac{1}{20} = 2$$

This means people are willing to exchange

2 Thai apples with 2 UK apples

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

cost of transportation or transaction
are small or zero so the price of the
same good in all countries should be
roughly the same or the same