Assignment no 1

For seminar Tuesday February 5 2008

A) Do exercise 2 in Ch 1 in Obstfeld and Rogoff's book (page 55).

B) Assume an endowment economy with two-periods and two countries. In the first period the home government has an endowment of the single commodity Y_G.

   a. What are the effects of Y_G on the current account and on the interest rate?

   b. What can the answer to a tell us about the effects of the recent increase in oil prices? What additional effects would it be important to take account of?

   c. Drop Y_G. Suppose the home government in the first period gets a gift, X, from the foreign government. What are the effects of this gift? How do they compare with the effects ofY_G?

C) Look at the two-by-two model with productive capital and investment. Suppose both countries have identical utility functions and productions functions, except for the proportional productivity factor, which is twice as high in Home as in Foreign. The productivity factor in each country is constant over time.

   a. Explain why there can still be an initial imbalance in the current account. What can you say about the real interest rate and about first period investment?

   b. Suppose that a transfer of technology immediately raises foreign productivity to the same level as home productivity. How would this affect investment and the current account? Would it have any effect on the world interest rate?