

International Economics

January 12, 2020

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Problem Set 5 - International Accounting

References: Alan Deardoff's Econ 541 Problem Set and Chapter 13 of Krugman, Obstfeld, Melitz International Economics

Exercise 1: The Balance of Payment (I)

Explain how each of the following transactions generates two entries (A Credit and a Debit) in the German BoP accounts, and describe *how* each entry would be classified.

- a. A German investor buys a share of a company in Ukraine, paying by writing a check in an account with a Luxembourg bank.
- b. Another German investor buys a share of Serbian Stock Company, paying the seller with a check on a German Bank.
- c. The Ukrainian government carries out an official foreign exchange intervention in which it uses Euros held by a German Bank to buy Ukrainians Hryvnias from its citizens.
- d. A tourist from Bielefeld buys a meal at an exclusive (and expensive) restaurant in Kiev, paying with a traveler's check.
- e. A German Brewer contributes a barrel of beer for a charity event in Lille.
- f. A German-owned factory in Mongolia uses local revenues to buy additional machinery.

Exercise 2: The Balance of Payments (II)

Suppose that during the year 2019, all of the international transactions of Germany were those listed below. Enter them into the country's balance of payments accounts below, identifying each with its ID (the index to which it appears in the list).

- a. A German corporation sells a shipment of hot gas to France, accepting as payment 750 Euro worth of shares in a Chinese laundry in Paris.
- b. A group of German children collects 140 Euro worth of canned vegetables which they send to a group of undernourished fashion models in New York City.
- c. A German father orders Ned Gramlich's book on Benefit-Cost Analysis as a birthday gift for his 12-year old daughter, charging it to his Visa card issued by Citibank in New York. The price of the book is 0.15 Euro.

- d. The German president buys an Exocet missile from a French firm for 3,000,000 Euro, promising that the next administration will pay for it. She then contributes the missile to the government of an unnamed country as "humanitarian aid."
- e. Russ Baren, a wealthy German businessperson, withdraws 10,000,000 Dollars from his American bank account, exchanges it for 2,340,000 Euro in the foreign exchange market, and deposits the Euros into his campaign fund where they are used to purchase German treasury bills from a resident of Hong Kong.
- f. Karentian Hellmann, daughter of Susan, is paid royalties of 1,740 Euro on sales of a book that she had previously ghost-written in the name of the family cat and published with a Japanese publisher. The royalties arrive from the publisher as a packet of small-denomination Euro notes in a plain brown wrapper.
- g. The national treasury of Germany makes interest payments on its national debt, including a check for 3,178 Euros to U.S. resident Mary Corcoran. Corcoran mislays it and does not cash it until the end of year 2020.
- h. The Ford School of the University of Michigan, having commissioned construction of a subsidiary in Bielefeld, purchases architectural drawings of the building from a German firm. It pays 450,000 Euros for these, writing a check on the School's account in the Deutsche Bank.
- i. The Deutsche Bank reports an increase of 42,000 Euros in its deposits. The deposit was in fact made by the American rock star Billy Joel, but because the deposit slip bore no name, the bank does not know where this money came from.
- j. The German Reserve Bank, which is the central bank of Germany, uses part of its reserves of Canadian dollars to purchase 815,000 Euros from a Canadian student who wishes to liquidate her deposits in the Deutsche Bank out of fear of a Euro devaluation.

| | | Credits (+) | ID | Debits (-) | ID |
|---|---------|-------------|----|------------|----|
| Current Account | | | | | |
| Merchandise | | 750 | a | | |
| | | | | | |
| Services | | | | | |
| | | | | | |
| Investment Income | | | | | |
| | | | | | |
| Unilateral Transfers | | | | | |
| | Private | | | | |
| | Public | | | | |
| | | | | | |
| Financial Account | | | | | |
| German Assets Abroad | | | | | |
| German Official Reserves and other Assets | | | | | |
| | | | | | |
| German Private Assets | | | | | |
| Direct Investment Abroad | | | | | |
| Foreign Securities | | | | 750 | a |
| Bank and Non-bank Claims and Currency | | | | | |
| | | | | | |
| Foreign Assets in Germany | | | | | |
| Foreign Official Assets in Germany | | | | | |
| | | | | | |
| Foreign Private Assets in Germany | | | | | |
| Direct Investment in Germany | | | | | |
| German Securities | | | | | |
| Bank and Non-bank Claims and Currency | | | | | |
| | | | | | |
| Statistical Discepancy | | | | | |

Figure 1:
Balance of
Payments of
Germany, 2020

| | |
|--|-------|
| Memoranda | |
| Balance on Merchandise Trade | _____ |
| Balance on Goods, Services, and Income | _____ |
| Balance on Current Account | _____ |
| Balance on Financial Account | _____ |
| Change in Reserves | _____ |

Exercise 3: Open Question

- a. Can you think of reasons why a government might be concerned about a large current account deficit or surplus? Why might a government be concerned about its official settlements balance (that is, its balance of payments)?
- b. Consider the following equation:

$$S^p = I + CA - S^G = I + CA - (T - G) = I + CA + (G - T) \quad (1)$$

The equation tells us that to reduce a current account deficit, a country must increase its private saving, reduce domestic investment, or cut its government budget deficit. Let's think to the case of the United States of America. Nowadays, some people recommend restrictions on imports from China (and other countries) to reduce the current account deficit. How would higher U.S. barriers to imports affect its private saving, domestic investment, and government deficit? Do you agree that import restrictions would necessarily reduce a U.S. current account deficit?