

## **Practice Problems on Open Economy Basics**

Updated: 09/08/2011

1. State the national income identity and name each variable. Next, identify domestic absorption and rewrite the identity in terms of domestic production, domestic absorption, and net exports.
2. If net exports are zero, does this imply that the country is in autarky? Discuss.
3. Using the national income identity, explain why trade deficits must be financed by borrowing or changes in reserves. Be sure to write the balance of payments identity and explain it.
4. Discuss what it means that normal trade deficits and surpluses are just an economy smoothing consumption over time.
5. Suppose a country's current account is in balance. Does this mean that their trade balance is zero as well? Explain.
6. When could it be possible for a country to have a trade deficit but a zero (or even positive) current account? Is this sustainable? Explain.
7. Write the definition of private savings.
8. Write the definition of public savings.
9. Write the national income identity in terms of savings, investment and net exports.