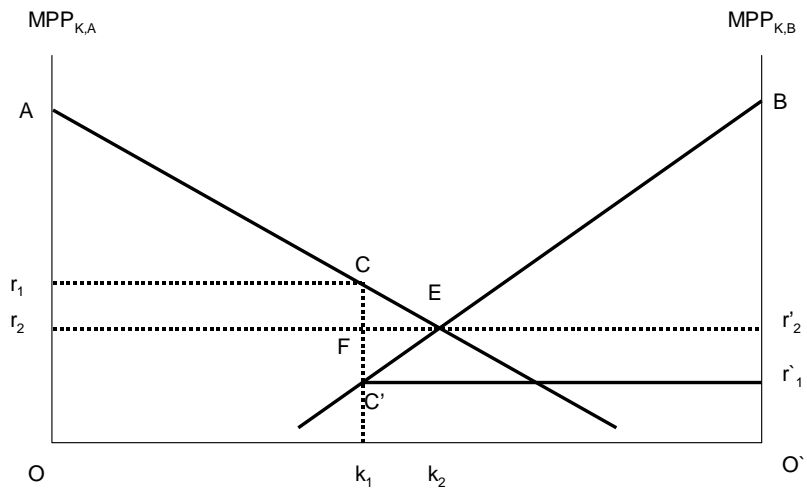


ECON 305
INTERNATIONAL ECONOMICS I
 Dr. Yetkiner

10 December 2007

Exercise 7
International Factor Movements

1. Suppose that the following capital market equilibrium is given for two countries. Answer the following questions by using the figure below.



Answer the following questions before capital moves.

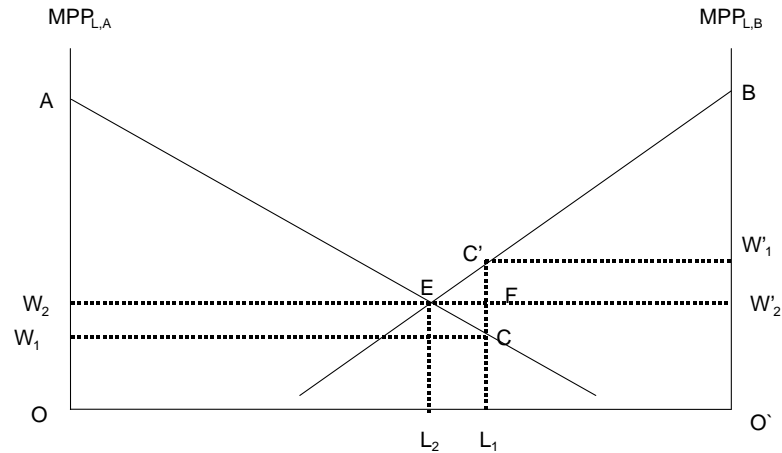
- (i) The rental rate of capital in Country A (Country B) is
- (ii) Total output in Country A (Country B) is equal to the area
- (iii) The rental capital income in Country A (Country B) is equal to the area
- (iv) Workers in Country A (Country B) receive

Answer the following questions after capital moves.

- (v) Capital will move from Country _____ to Country _____.

- (vi) The amount of capital that moves is
- (vii) The rental rate of capital is _____ in Country A after the capital movement.
- (viii) Output in country A (Country B) will rise after capital movement. True or false. Prove.
- (ix) World output after foreign direct investment will decrease. True or false. Prove.
- (x) Why may free factor mobility be a good substitute for free trade?
- (xi) Rental capital income in Country A (Country B) will increase after FDI. True or false. Prove.
- (xii) Wage income in Country A (Country B) will increase after FDI. True or false. Prove.
- (xiii) Total income in Country A (Country B) will increase after FDI. True or false. Prove.
- (xiv) Total world income will increase after FDI. True or false. Prove.

2. Suppose two countries, Indonesia (Country A) and Japan (Country B), decided to allow free labor movement between them. Assume that, relatively speaking, Indonesia is a labor-abundant country and Japan is a capital-abundant one. Hence, the wage rate in Indonesia is less than in Japan. In the boxes below indicate the effect of free labor movement on the variables listed in the first column in both Indonesia and Japan. You may also exploit the following figure for your answers:



	in Indonesia	in Japan	World
The rental rate of labor			Not applicable
Labor employed			
Total output			
Capital-owners receive			
Labor-owners receive			
Labor will move from			Not applicable
The labor movement amounts to			
The new rental rate of labor is			
The new output is (increase/decrease/)			
Labor-owners' income			
capital-owners' income			
Immigrants earn			