Prof. Dr. Karl-Heinz Paqué Summer Term 2011

Examination
for the lecture
"Introduction to International Economics"
11038

Preliminary Remarks:

- **Time**: 2 hours
- **Aids:** no aids are allowed, except one bilingual dictionary.
- **Language:** English. Answers in German are possible for students who are registered in German-speaking programs of the University.
- **Structure:** 2 parts (I, II). Part I consists of 20 multiple choice questions (1-20) and part II consists of two questions (1, 2).
  In part I, all multiple choice questions are weighted equally. For each correctly answered question 3 points are given; for each incorrectly answered question 0 points are given. **There may be one or several correct choices (a-d) for each question.** A question is only correctly answered if all correct choices are marked. In part I, a maximum of 60 points can be reached.
  In part II, the two questions are to be answered using standard tools of economic reasoning. In each question, a maximum of 30 points can be reached.

Part I (60 points):

Please mark the correct answers with **X** in the table below:

	A	B	C	D
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				

	A	B	C	D
11				
12				
13				
14				
15				
16				
17				
18				
19				
20				

1. Which one of the following is an assumption contained in the Ricardo trade model?

A) Factors of production (labor) are completely mobile within a country.
B) Factors of production (labor) are completely mobile between countries.
C) Marginal costs are constant as production increases for a firm/industry.
D) Transportation costs of goods between countries are zero.

2. The following Ricardo-type table shows the labor input required per unit of output in each of the two industries in each of the two countries:

	Shirts	Brandy
United States	8 days	10 days
France	2 days	10 days

Which one of the following statements is correct?

A) France's pretrade price ratio is 5 brandy = 1 shirts.
B) The US pretrade price ratio is 1 brandy = 5/4 shirts.
C) The US pretrade price ratio is 4 shirt = 1 brandy.
D) The United States has a comparative advantage in shirts.

3. In the situation in Question 2 above, if the countries engage in trade at posttrade prices (terms of trade) of 1 shirt = 0.5 brandy, then

A) France gains from trade.
B) The United States gain from trade.
C) None of the countries gains from trade.
D) The two countries share in the gains from trade.

4. The following Ricardo-type table shows the labor input required per unit of output in each of the two industries in each of the two countries. Suppose that Germany is a much larger country in terms of production and income than the United Kingdom. In this situation, other things equal, when the countries engage in trade, the posttrade price ratio (terms of trade) would tend to settle __________, and __________ would therefore tend to have relatively large gains from trade.

	Steel	Cloth
United Kingdom	3 days	9 days
Germany	5 days	10 days

A) toward a value of 1 cloth = 3 steel; the United Kingdom
B) toward a value of 1 cloth = 2 steel; the United Kingdom
C) toward a value of 1 cloth = 2 steel; Germany
D) toward a value of 1 cloth = 2.5 steel; both countries

5. The assumption of ______ costs of production in the Ricardo model results in a __________ production possibilities frontier, and, in the case of a "small" country, __________ specialization in production when trade takes place.

A) increasing; linear; incomplete
B) decreasing; concave-to-the-origin; complete
C) constant; linear; complete
D) constant; linear; incomplete

6. If relatively labor-abundant country A opens trade with relatively capital-abundant country B and the trade takes place in accordance with the Heckscher-Ohlin theorem, what would be the consequence for the factor price ratio (w/r) in the two countries?

A) (w/r) falls in B
B) (w/r) rises in B
C) (w/r) rises in A
D) (w/r) falls in A

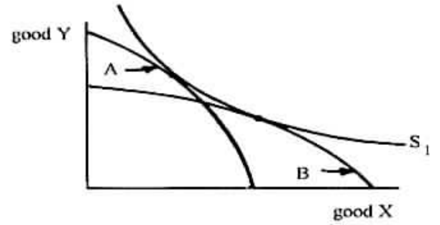
7. In the Heckscher-Ohlin model of trade, the movement of a country from autarky to free trade generally results in __________ specialization in production, __________ the situation in the Ricardo model.

A) incomplete; in contrast to
B) complete; as was also
C) partial; unlike
D) partial; as was also

8. In the Heckscher-Ohlin model of trade with two goods X and Y, if a country's P_X/P_Y in autarky is greater than the P_X/P_Y on the world market, then this country has a comparative advantage in the __________ good, and, if the country now engages in international trade and moves along its production possibilities frontier, its production of the X good will __________.

A) Y; increase
B) Y; decrease
C) X; not change
D) X; increase

9. Given the following graph showing production possibilities frontiers for country A and country B in a situation where both countries are on the same community indifference curve S1 in autarky:



Prior to trade, P_X/P_Y in country A is __________ P_X/P_Y in country B, and, when trade begins, country A will import good __________.

A) greater than; X
B) greater than; Y
C) less than; X
D) less than; Y

10. In a Heckscher-Ohlin context, other things equal, growth of the supply of the relatively scarce factor of production in a country that is a large country will lead to __________ willingness to trade and to __________ in the country's terms of trade.

A) an increased; a deterioration
B) an increased; an improvement
C) a decreased; a deterioration
D) a decreased; an improvement

11. If, at constant relative prices in a two-commodity and two-factor world, growth in a country's labor force causes an expansion in output of the labor-intensive good and a contraction in output of the capital-intensive good, this situation is an example of the

A) Stolper-Samuelson Theorem.
B) Rybczynski Theorem.
C) Heckscher-Ohlin Theorem.
D) Leontief paradox.

12. If two countries with increasing opportunity costs have identical production possibility frontiers and identical tastes, then

A) the countries will have identical relative commodity prices under autarky, and there will be no incentive for them to trade with each other.
B) the countries will have different relative commodity prices under autarky, but there will still be no incentive for them to trade.
C) the countries will have identical relative commodity prices under autarky, but each country can gain by exporting the good for which its consumers have the lower relative preference.
D) the countries will have different relative commodity prices under autarky, and each country can gain by importing the good for which its consumers have the lower relative preference.

13. Which of the following is an example of a nontariff barrier to the free flow of goods and services in accordance with comparative advantage?

A) import quotas
B) government procurement provisions that favour home products
C) specific duty of $1.00 per unit on each imported item
D) voluntary export quotas (VERs)

14. In the large-country case, an export subsidy

A) leads to an increase in the price of the good in the importing country.
B) will lead to a net gain in welfare in the exporting country since producer surplus is enhanced.
C) is absorbed partially by the exporting country.
D) decreases consumer welfare in the exporting country.

15. When a country's currency depreciates,
A) foreigners find that its imports are cheaper, and domestic residents find that imports from abroad are more expensive.
B) foreigners find that its exports are more expensive, and domestic residents find that imports from abroad are cheaper.
C) the relative price of its imports rises and the relative price of its exports falls.
D) foreigners are not affected, but domestic residents find that imports from abroad are more expensive.

16. If a Big Mac costs $4.00 in the United States and 200 yen in Japan, then the implied "purchasing-power-parity" exchange rate using the Big Mac is __________. If the actual exchange rate in the market is 120 yen = $1, then an economist would say that the actual Japanese yen is __________ in comparison with its "purchasing-power-parity" rate.

A) 800 yen = $1; undervalued
B) 800 yen = $1; overvalued
C) 50 yen = $1; undervalued
D) 50 yen = $1; overvalued

17. What is the expected dollar rate of return on dollar deposits with today's exchange rate at $1.10 per euro, next year's expected exchange rate at $1.165 per euro, the dollar interest rate at 10%, and the euro interest rate at 5%?
A) 10%
B) 11%
C) -1%
D) 0%

18. In the ordinary analysis of IS and LM curves,

A) expansionary fiscal policy shifts the IS curve to the left.
B) expansionary monetary policy shifts the LM curve to the right.
C) expansionary fiscal and expansionary monetary policy undertaken at the same time will lead to an increase in the level of equilibrium income.
D) expansionary fiscal policy and contractionary monetary policy acting together will lead to a decline in the equilibrium interest rate.

19. In the IS-LM analysis of a closed economy, an increase in the demand for money shifts the LM curve to the __________; other things equal, this will lead to __________ in the level of national income.

A) right; an increase
B) right; a decrease
C) left; an increase
D) left; a decrease

20. In the IS-LM framework, which one of the following statements is true?

A) Fiscal policy is unambiguously more effective in influencing national income under flexible exchange rates than under fixed exchange rates.
B) Fiscal policy is unambiguously more effective in influencing national income under fixed exchange rates than under flexible exchange rates.
C) Monetary policy is unambiguously more effective in influencing national income under flexible exchange rates than under fixed exchange rates.
D) Monetary policy is unambiguously more effective in influencing national income under fixed exchange rates than under flexible exchange rates.

Part II (60 points):

Question 1 (30 points):

Assume a **standard trade** model with two large countries Home and Foreign, two goods X and Y and two factors of production Labour (L) and Capital (K). Show **graphically** and explain **verbally** how

(a) an international income transfer from Home to Foreign
(b) a so-called export-biased growth in Home

affect the structure of trade (exports and imports), production and consumption as well as the terms-of-trade of both countries.

(c) What is immiserizing growth?

Question 2 (30 points):

Assume an **open economy** in the **long run** under the standard assumptions as specified in the lecture.

(a) State and explain the standard assumptions. Please use also formulas/equations.
(b) Show **graphically** and **explain** economically the effects of a **decrease of government expenditure** on the interest rate, the real exchange rate as well as domestic investment and net foreign investment.
(c) Assume now **fixed** nominal exchange rates. How do the results change? Answer this question using graphs and economic reasoning.