"INTRODUCTION TO INTERNATIONAL ECONOMICS" (11038)

Summer Term 2013
Tue, July 16, 2013, 11.00-13.00 a.m., G3/315
Prof. Dr. Karl-Heinz Paqué, VWL-IW

Name: ______________________________

Matr.-No.: ____________________________

Preliminary Remarks:

- **Time**: 2 hours
- **Aids**: no aids are allowed, except one bilingual dictionary and one non-programmable pocket calculator.
- **Language**: English. Answers in German are possible for students who are registered in German-speaking programs of the University.
- **Structure**: The exam consists of two parts (I, II). Part I consists of 20 multiple choice questions (1-20) worth 60 points in total (3 points each in case of correctly answered question and 0 points in case of wrongly answered question). For each multiple choice type question, several possible answer choices are listed. Note that **there may be several true statements for each question**. The correct answer is the choice that contains **all** true statements in response to the question. Please choose the correct statement(s) among the four provided and mark your answers on the answer sheet below. Part II consists of two open questions worth 60 points in total (30 points each). Both questions are to be answered using standard tools of economic reasoning. The exam is worth 120 points in total.

Part I (60 points):

Please mark your answers on the answer sheet below:

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

	A	B	C	D
11				
12				
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19				
20				

1. Given the information in Table 1, in a two-country and two-product Ricardian model, which of the following statements is (are) true?

Table 1	Unit Labour Requirements	
	T-shirt	Brandy
United States	4 hours	12 hours
France	6 hours	12 hours

A) The pretrade price ratio in France is 1 brandy = 2 T-shirts.
B) The US pretrade price ratio is 1 brandy = 4 T-shirts.
C) The US pretrade price ratio is 1 T-shirt = 1/3 brandy.
D) The United States has a comparative advantage in T-shirts.

2. Given the information in Table 1, if the world equilibrium price of one T-shirt were 0.5 brandy, then

A) both countries will benefit equally from trade with each other.
B) France but not the United States will gain from trade.
C) the United States but not France will gain from trade.
D) neither the United States nor France will gain from trade.

3. Given the information in Table 2, according to the Ricardian model, if country A is assumed to be much larger compared to country B, then, other things equal, once trade occurs, the world terms of trade will be equal to a value of ___________, and only ___________ will enjoy gains from trade.

Table 2	Unit Labour Requirements	
	Wine	Cloth
Country A	12 hours	3 hours
Country B	9 hours	3 hours

A) 1 wine = 4 cloths; country A.
B) 1 wine = 4 cloths; country B.
C) 1 wine = 3 cloths; country A.
D) 1 wine = 3 cloths; country B.

4. If, in the above-described Ricardian model, there is a home product taste bias in country A, then

A) country A must also enjoy a comparative advantage in Wine.
B) country A may end up exporting Wine.
C) country B may switch to having a comparative advantage in Cloth.
D) none of the above.

5. Which of the following statements characterize(s) the Heckscher-Ohlin model?

A) Constant returns to scale.
B) Monopolistic competition.
C) Perfect mobility of factors across countries.
D) Perfect mobility of factors across industries.

6. Refer to Table 3. If good S is capital intensive, then following the Heckscher-Ohlin Theory, if trade were to open up between these two countries,

Table 3	Factor Endowments	
	Labour Force	Capital Stock
Country A	150	450
Country B	100	200

A) country A will export good S.
B) country B will export good S.
C) the world price of good S would be higher than it had been in country A.
D) the world price of good S would be lower than it had been in country A.

7. Given the information in Table 3, following the Heckscher-Ohlin Theory, if trade were to open up between these two countries,

A) the real income of labour in the country A would rise.
B) the real income of labour in the country B would rise.
C) the real income of capital owners in the country A would rise.
D) the real income of capital owners in both countries would fall.

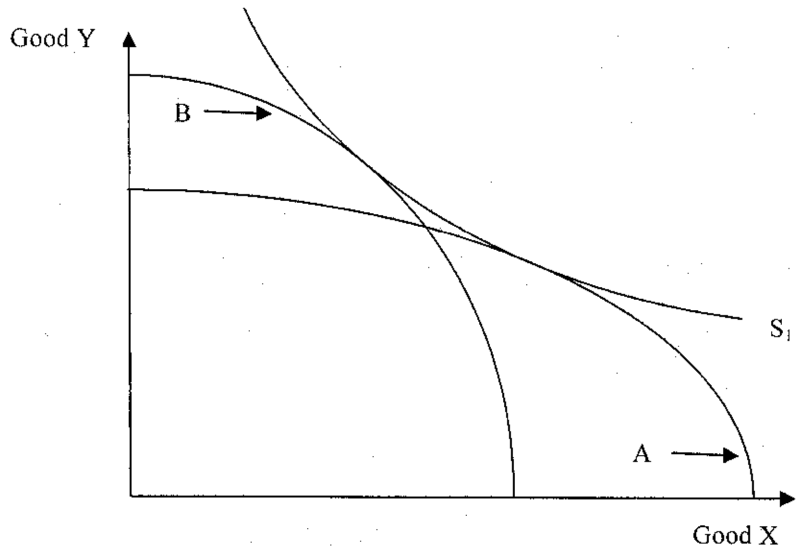
8. If two countries with diminishing returns of factors of production and different marginal rates of substitution between two products were to engage in trade, then

A) marginal costs of both countries would become equal.
B) shapes of their respective production possibility frontiers would change.
C) marginal rates of substitution of both countries would become equal.
D) marginal rate of substitution of the exporting country would become higher.

9. Suppose that country A is a small country and its production possibility frontier shifts out relatively more toward its exported good, cloth,

A) this will tend to worsen the terms of trade of country A.
B) this will tend to improve the terms of trade of country A.
C) this will have no effect on the terms of trade of country B.
D) this will tend to worsen the terms of trade of country B.

10. Refer to Figure 1 "The Production Possibility Frontiers for Country A and Country B given the Common Community Indifference Curve S_1 in Autarky".



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

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

11. Suppose that country A produces two goods, beer and wine. If it specializes in the production of beer, and has (compared to country B) a strong preference for consuming beer, then a transfer of income by country A to country B

A) will increase the equilibrium relative price of beer.
B) will reduce the equilibrium relative price of beer.
C) will tend to worsen the terms-of-trade of country B.
D) will tend to improve the terms-of-trade of country B.

12. In the exporting country, an export subsidy will

A) help consumers and raise the overall economic welfare of the exporting country.
B) hurt consumers and lower the overall economic welfare of the exporting country.
C) hurt consumers but raise the overall economic welfare of the exporting country.
D) help exporters but lower the overall economic welfare of the exporting country.

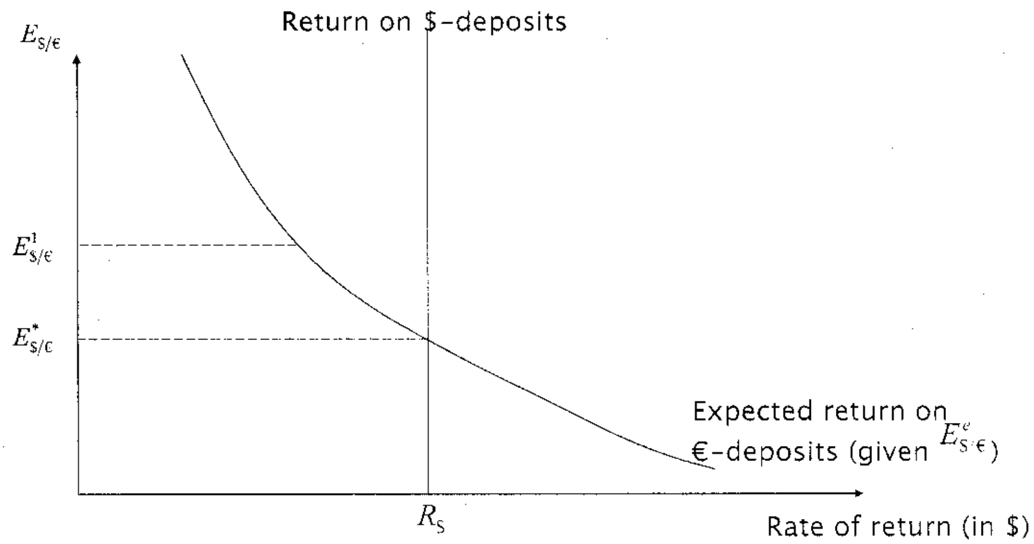
13. If the interest parity condition holds, what should be the euro interest rate with today's exchange rate at \$1.147 per euro, next year's expected exchange rate at \$1.03, and the dollar interest rate at 1%?

A) 11%
B) -4%
C) 6%
D) 0%

14. Let Y stand for GNP, C for consumption, I for investment, G for government purchases, T for net taxes, and S_p for private saving. If a country has a current account deficit, which of the following statements is (are) true?

A) $C - Y > 0$
B) $Y - (C + I + G) < 0$
C) $S_p = I + (G - T)$
D) $S_p + T - G < I$

15. Refer to Figure 2 "Interest Rate Parity and Exchange Rate Determination". At $E^1_{\$/€}$,



A) the Dollar is currently undervalued.
B) the Dollar is currently overvalued.
C) excess demand for \$-assets will cause a \$-revaluation.
D) excess demand for \$-assets will cause a \$-devaluation.

16. Which of the following would cause the real exchange rate to rise?

A) a rise in the nominal exchange rate.
B) a right shift of the aggregate demand curve.
C) a rise in foreign prices.
D) a rise in domestic prices.

17. According to the IS-LM Model,

A) contractionary fiscal policy leads to a rightward shift of the IS-curve.
B) expansionary monetary policy leads to a rightward shift of the LM-curve.
C) contractionary fiscal and contractionary monetary policy undertaken at the same time will lead to an increase in the level of the equilibrium income.
D) expansionary fiscal and expansionary monetary policy undertaken at the same time will lead to an increase in the level of the equilibrium income.

18. Suppose that a country A with flexible exchange rates undertakes an expansionary monetary policy. As a result of this policy, A's currency will tend to __________. In the short-run model, compared to the case of fixed exchange rates, A's monetary policy under flexible exchange rates will be __________ effective in influencing national income.

A) depreciate; less.
B) depreciate; more.
C) appreciate; less.
D) appreciate; more.

19. According to the IS-LM Model, which of the following statements is (are) true?

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

20. According to the IS-LM Model, if the economy is located at a point that is to the right (or above) the IS-curve and also to the right (or below) the LM-curve, investment is __________ than savings and there is an excess __________ money.

A) greater; demand for.
B) less; supply of.
C) less; demand for.
D) greater; supply of.

Part II (60 points):

Question 1 (30 points):

One of the oldest arguments used to justify the protection of industries from international trade is the infant industry argument.

(A) Why is it necessary to use a market failure to justify the infant industry protection? (10 points).

(B) What is a positive externality? Explain the argument of knowledge spillovers as a potential reason for infant industry protection (10 points).

(C) If infant industry protection is justified, is it better for the Home country to use a tariff or a quota, and why? (10 points).

Question 2 (30 points):

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

A) Show graphically and explain economically the effects of a rise of government expenditure on the interest rate, the real exchange rate as well as domestic investment and net foreign investment (20 points).

B) Assume now fixed nominal exchange rates. How do the results change? Answer this question using graphics and economic reasoning (10 points).

End of the exam. Good luck!