Original

Prof. Dr. Karl-Heinz Paqué **Winter Term 2008/9**

Examination
for the lecture
"Introduction to International Economics"
(11038)

Preliminary Remarks:

- ***Time:*** *2 hours.*
- ***Aids:*** *no aids are allowed, except a bilingual dictionary.*
- ***Language:*** *English. Answers in German are possible for students who are registered in German-speaking programmes of the University.*
- ***Structure:*** *4 questions (1,2,3,4). Each question is to be answered using standard tools of economic reasoning. Each question is weighted equally and consists of two parts. In each question, a maximum of 30 points can be reached. The total number of points is 120.*

Question 1:

Take a Ricardo model with two countries (Home and Foreign), two goods (cheese and wine) and one factor of production (labour).

(a) Assume that each of the two countries specializes in the production of the good that it produces with a comparative cost advantage. Show graphically that this form of specialization leads to gains from trade for all. Show the same algebraically, using the concept of trade as indirect production. Explain your results economically.

(b) Specialization may be, but need not be complete in each of the two countries. Explain economically why this is so. Show it graphically.

Question 2:

A country introduces an export subsidy for good x.

(a) Show graphically and explain verbally in a partial equilibrium analysis for the case of a subsidy (s) on any unit of exports of x how the subsidy affects prices, production and consumption as well as government revenues and the welfare of the country as a whole. Use the concepts of consumer and producer surplus.

(b) Is the size of the country relevant for the effects of the subsidy? Explain your answer.

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Question 3:

National money markets and foreign exchange markets are interlinked.

(a) Show this link graphically, assuming money market equilibrium and interest rate parity. Explain the link economically for a model setting with two countries (Home and Foreign).

(b) Assume that
- the money supply increases in Home,
- money demand declines in Foreign.

How does this affect the equilibrium combination of rates of return and the exchange rate, and why?

Question 4:

Assume an open economy in the short run under the standard assumptions of an underemployed economy.

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

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