Prof. Dr. Karl-Heinz Paqué **Summer Term 2009**

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:

In a Heckscher-Ohlin Model with two countries, two goods and two factors of production (land and labour), the emerging specialisation pattern leads to factor price equalization.

(a) Show graphically how this result comes about. Give an economic explanation of it.

(b) Explain why, in reality, we do not typically observe international factor price equalisation. Which assumptions, if any, of the model are violated in reality?

Question 2:

A country introduces an import tariff for good x.

(a) Show graphically and explain verbally in a partial equilibrium analysis how the tariff 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 tariff? Explain your answer.

Please, turn the page!

Question 3:

"Calculated in a common currency, the price level is equal in all countries. This is called purchasing power parity (PPP)."

(a) Define PPP in its absolute and its relative version. What is the economic logic of PPP? Describe the mechanism how it comes about.

(b) Is PPP a realistic assumption? Explain your answer. Distinguish the short run and the long run. Also distinguish between traded and non-traded goods.

Question 4:

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

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

(b) Assume now perfect capital mobility. How do the results change? Answer this question using graphics and economic reasoning.