"INTRODUCTION TO INTERNATIONAL ECONOMICS" (11038)

Winter Term 2012/13
Mon, Feb 4, 2013, 11.00-13.00 a.m., HS1
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				
13				
14				
15				
16				
17				
18				
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	
	Cell phone	Umbrella
France	16 hours	2 hours
Germany	4 hours	0.5 hours

A) The pretrade price ratio in Germany is 1 cell phone = 8 umbrellas.
B) The pretrade price ratio in France is 1 cell phone = 8 umbrellas.
C) The pretrade price ratio in France is 1 umbrella = 8 cell phones.
D) Germany has a comparative advantage in cell phones.

2. Given the information in Table 1, if the world equilibrium price of one umbrella were 1/10 cell phone, then

A) both countries will benefit equally from trade with each other.
B) France but not Germany will gain from trade.
C) Germany but not France will gain from trade.
D) neither Germany 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 smaller 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, transportation costs are especially high for Wine, 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.

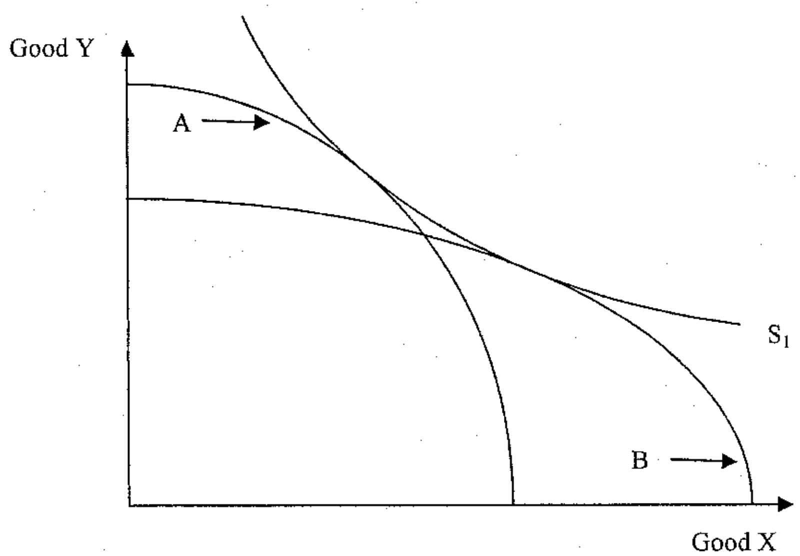
5. As __________ the Ricardian model of comparative advantage, according to the Heckscher-Ohlin model, a change from autarky to trade will generally result in __________ specialization in production.

A) opposed to; complete.
B) opposed to; partial.
C) well as in; complete.
D) well as in; partial.

6. According to the Heckscher-Ohlin model, if the stock of the relatively scarce factor of production in the "large" country increases, then, other things equal, the output of the good using that factor of production intensively will __________ and the country will tend to experience __________ terms of trade.

A) decrease; improving.
B) increase; improving.
C) decrease; deteriorating.
D) increase; deteriorating.

7. 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.

8. If two countries with diminishing returns 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 large country and its production possibility frontier shifts out relatively more toward its exported good, cloth,

A) this will tend to improve the terms of trade of country A.
B) this will tend to worsen 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 improve the terms of trade of country B.

10. After World War I, Germany was forced to make large reparations - transfers of real income - to France. Following John Maynard Keynes' theory, this should have caused

A) an improvement in Germany's terms of trade.
B) an improvement in France's terms of trade.
C) deterioration in Germany's terms of trade.
D) a fluctuation upward and then downward in their terms of trade.

11. Suppose that a small country A imposes a tariff on its imported good, this will tend to

A) have no effect on the terms of trade of country A.
B) Improve the terms of the trade of country A.
C) lower the world price of imported good.
D) raise the revenue of the government of country A.

12. The infant industry argument is that

A) comparative advantage is irrelevant to economic growth.
B) developing countries have a comparative advantage in agricultural goods.
C) developing countries have a comparative advantage in manufacturing.
D) developing countries have a potential comparative advantage in manufacturing.

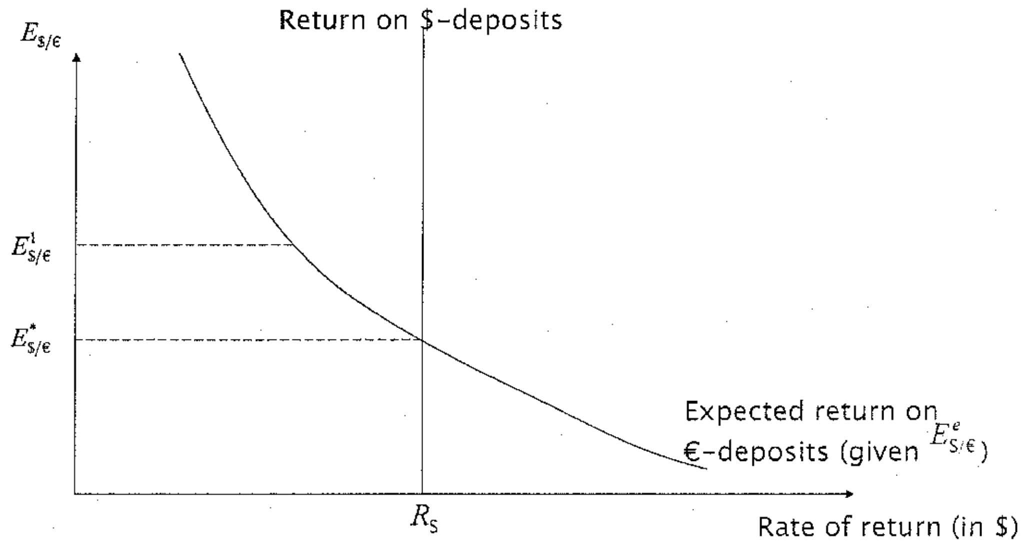
13. If the interest parity condition holds, what should be the euro interest rate with today's exchange rate at $1.149 per euro, next year's expected exchange rate at $1.09, and the dollar interest rate at 1%?

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

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 fall in domestic prices.

17. **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) appreciate; less.
B) appreciate; more.
C) depreciate; less.
D) depreciate; more.

18. 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.

19. In order for the purchasing power parity condition $E_{\$/€} = P_{US}/P_{EU}$ to hold, the following assumption(s) is (are) necessary:

A) No transportation costs and restrictions on trade; commodity baskets that are a reliable indication of price level.
B) Markets are perfectly competitive, i.e., P = MC.
C) The factors of production are identical between countries.
D) All of the above.

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 left (or above) 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):

In the Heckscher-Ohlin model with two countries, Home (H) and Foreign (F), that produce two goods, cloth (c) and food (f), with two factors of production, Labour (L) and Land (T), the home country is labour-abundant, while the foreign country is land-abundant. Cloth is the labour-intensive good.

(A) Given a common relative price of cloth in H and F, plot the production possibility frontiers with factor substitution for each country and show in which way Home's PPF and Foreign's PPF* are biased (5 points).
(B) Draw the relative demand and supply curves for H and F. Compare their autarky relative prices of cloth (5 points).
(C) Analyze the pattern of trade and specialization. Evaluate the gains from trade for each country (10 points).
(D) Show graphically and explain verbally that (and how) trade leads to international factor price equalization (10 points).

Question 2 (30 points):

Assume an open economy in the short run under flexible exchange rates.

A) Show graphically and explain economically how an expansionary fiscal policy affects the interest rate, the exchange rate, investments and net exports (20 points).
B) Consider the case of fixed exchange rates. Show graphically and explain verbally how the results of the above described policy change (10 points).

End of the exam. Good luck!