

**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 programs of the University.
 - **Structure:** 2 parts (I, II). Part I consists of 30 multiple choice questions (1-30) and part II consists of two questions (1, 2). In part I, all multiple choice questions are weighted equally. For each right answer 2 points are given, for each wrong answer 1 point is *subtracted*, whereas no answer allows for 0 points. There is only *one* right answer for each question. If the total sum of points is *negative*, then 0 points will be accounted for Part I. In part I, a maximum of 60 points can be reached. In part II, both questions are to be answered using standard tools of economic reasoning. In each question, a maximum of 30 points can be reached. The total number of points is 120.
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Part I (60 points):

Please check the right answer with X in the table below:

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	A	B	C	D	E
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1 According to the principles of comparative advantage, a country engaging in trade gains from trade because it

- A) is producing exports indirectly using fewer labor hours
- B) is producing exports indirectly more efficiently than it could alternatively
- C) is producing imports directly using fewer labor hours
- D) is producing imports indirectly more efficiently than it could domestically
- E) none of the above

Table 1	<i>Unit labor requirements</i>	
	Cheese	Wine
Home	1	4
Foreign	3	6

2 Given the information in Table 1 above, assume that wages in Foreign are €10 per hour. If wages were to double in Foreign,

- A) Home will export cheese, whereas initially it would have exported wine
- B) Home will export cheese as it was initially supposed to do
- C) Foreign will export wine, whereas initially it would have exported cheese
- D) Foreign will export cheese, whereas initially it would have exported wine
- E) Foreign will export cheese as it was initially supposed to do

3 Assume that labor is the only factor of production and that wages in Germany are equal to €10 per hour while wages in Czech Republic are €5 per hour. Production costs would be lower in Germany as compared to Czech Republic if

- A) the labor productivity in Germany equaled 20 units per hour, and in Czech Republic 30 units per hour
- B) the labor productivity in Germany equaled 10 units per hour as well as in Czech Republic
- C) the labor productivity in Germany equaled 25 units per hour, and in Czech Republic 20 units per hour
- D) the labor productivity in Germany equaled 5 units per hour, and in Czech Republic 10 units per hour
- E) the labor productivity in Germany equaled 30 units per hour, and in Czech Republic 10 units per hour

4 Assume two countries, UK and Moldova. Given the Ricardian model, if the world terms of trade equal to those of UK, then

- A) both countries will gain from trade
- B) UK, but not Moldova will gain from trade
- C) Moldova, but not UK will gain from trade
- D) only the country whose government subsidizes its exports will gain from trade
- E) only the country whose government puts barriers on imports will gain from trade

5 Assume the Heckscher-Ohlin model. Which of the statements is correct?

- A) The losses of the trade-related losers overcompensate the gains of the winners
- B) Trade is not beneficial because it decreases the real income of the scarce factors in society
- C) Differences in technologies cannot be the source of gains from trade
- D) The direction of trade (who exports what to whom) cannot be altered by differences in tastes in two countries
- E) None of the above

Table 2 Factor Endowments	Countries	
	Home	Foreign
Labor Force	50	100
Capital Stock	20	30

6 Given the information in Table 2, once trade begins, then according to the Heckscher-Ohlin theory

- A) rents and wages should rise in Home
- B) rents rise and wages decline in Home
- C) rents rise and wages decline in Foreign
- D) rents and wages rise in Foreign
- E) rents and wages rise both in Home and Foreign

7 Refer to Table 2 above. Suppose that in Home the real value of production is equal to 210 whereas in Foreign it is equal to 190. By knowing that the real wage is equal to 4 in Home and the real rent of capital to 3 in Foreign, which of the following will be a plausible consequence of trade in the Heckscher-Ohlin model?

- A) The real wage has become 1.5, whereas the real rent of capital 2
- B) The real wage has become 0.5, whereas the real rent of capital 4
- C) The real wage has become 2, whereas the real rent of capital has become 5
- D) The real wage has become 0.5, whereas the real capital of land 1
- E) The information is not sufficient to draw any of the above conclusions

8 Refer to the Table 2 above. If good S is produced capital intensively, whereas P labor intensively, then following the Heckscher-Ohlin theory

- A) Home will export S and import P
- B) Foreign will export S and import P
- C) both, Home and Foreign, will export P
- D) trade will not occur between the two countries
- E) the information is not sufficient to draw any of the above conclusions

9 In a standard trade model

- A) the concept of “terms of trade” represents the price of a country’s exports divided by the price of its imports
- B) a country produces a mix of products with a higher value than the point where the isovalue line is above the indifference curve
- C) tastes of individuals are represented by the indifference curves
- D) both A) and C) are correct
- E) A), B) and C) are correct

10 Argentina produces two goods, cloth (C) and food (F) with prices P_C and P_F , respectively. If P_C/P_F were to increase in Argentina, which is a major importer of cloth, then

- A) the terms of trade of Argentina would improve
- B) the terms of trade of both Argentina and its trading partners would improve
- C) the terms of trade of Argentina would deteriorate
- D) the terms of trade of its trading partners would deteriorate
- E) none of the above is correct

11 Refer to the example in question 10. If P_C/P_F were to increase in Argentina with the substitution effect outweighing the income effect, then

- A) the consumption of both goods will increase
- B) the consumption of both goods will decrease
- C) the consumption of cloth will decrease, and the consumption of food will increase
- D) the consumption of cloth will increase, and the consumption of food will decrease
- E) the information is not sufficient to draw any of the above conclusions

12 Assume two countries, United States and Somalia. Somalia is receiving an emergency aid from the United States Agency for International Development (USAID). If Somalia has a higher marginal propensity to consume on its imports than does the United States, then such aid will

- A) leave the terms of trade unaffected
- B) deteriorate the terms of trade of both US and Somalia
- C) worsen the US terms of trade
- D) improve the US terms of trade
- E) lead to none of the above

- 13 Economic growth could result in a country being worse-off than before growth. Which of the following answers could support this argument?**
- A) Import-biased growth
 - B) Unbiased growth
 - C) Balanced growth
 - D) Nominal growth
 - E) Immiserizing growth
- 14 Greece introduces an export subsidy on its manufactured goods. The subsidy will**
- A) hurt producers of manufactured goods and decrease the economic welfare of Greece
 - B) favor producers of manufactured goods but decrease the economic welfare of Greece
 - C) hurt consumers of manufactured goods but increase the economic welfare of Greece
 - D) favor consumers of manufactured goods and decrease the economic welfare of Greece
 - E) hurt producers and consumers of manufactured goods and decrease the economic welfare of Greece
- 15 If Romania is a small country in world trade, then**
- A) the imposition of a tariff on its imports will cause an increase in its overall national welfare
 - B) the imposition of a tariff will cause either a fall or an increase in its national welfare
 - C) the imposition of a subsidy on its exports will cause an increase in its overall national welfare
 - D) the imposition of a subsidy on its exports will have no effects on its overall welfare
 - E) none of the above is correct
- 16 The existence of marginal social benefits which are not marginal benefits for the industry producing the import substitutes**
- A) is an argument supporting free trade and non-governmental involvement
 - B) is an argument against inefficient production
 - C) is an argument supporting the use of market failures as a trade-policy strategy
 - D) is an argument against free trade and supporting governmental involvement
 - E) is none of the above
- 17 Which of the following statements is correct?**
- A) The pattern of specialization established by a historical accident may persist even when new producers could potentially have lower costs
 - B) The spillover of knowledge gives rise to a situation in which the production costs of individual firms rise as the industry as a whole accumulates experience
 - C) The learning curve shows that unit cost is lower the greater the output of a country's industry
 - D) When costs rise with cumulative production over time, this is referred to as a case of dynamic increasing returns

- E) The argument for free trade and non-governmental involvement is known as the infant industry argument.

18 The balance of payments is the sum of

- A) the current account balance, the capital account balance, the non reserve portion of the financial account balance, the statistical discrepancy
B) the current account balance, the capital account balance, the non reserve portion of the financial account balance
C) the current account balance and the non reserve portion of the financial account balance
D) the capital account balance and the non reserve portion of the financial account
E) the current account balance and the capital account balance

19 Assume the law of one price. What is then the exchange rate between the dollar and Swiss francs, if a pair of Levi's jeans costs 100 dollars in San Francisco and 80 Swiss francs in Zurich.

- A) 0,8 dollars per Swiss franc
B) 1,8 dollars per Swiss franc
C) 0,25 dollars per Swiss franc
D) 1,25 dollars per Swiss franc
E) The information is not sufficient to draw any of the above conclusions

20 Refer to the example in Question 19. If the money price of Levi's jeans does not change, which of the following could be a plausible exchange rate as a result of a depreciation of the Swiss franc against the dollar.

- A) 0,8 dollars per Swiss franc
B) 1,8 dollars per Swiss franc
C) 1,25 dollars per Swiss franc
D) 1,5 dollars per Swiss franc
E) The information is not sufficient to draw any of the above conclusions

21 Refer to the example in Question 19. As a result of a depreciation of the Swiss franc against the dollar,

- A) the real price of Levi's jeans stayed the same
B) Levi's jeans became more expensive for American customers
C) Levi's jeans became more expensive for Swiss customers
D) Levi's jeans became cheaper for Swiss customers
E) the information is not sufficient to draw any of the above conclusions

- 22 Which of the following statements is correct?**
- A) The government is the major actor at the centre of foreign exchange market
 - B) The action of arbitrage is the process of buying a currency cheap and selling it dear
 - C) The price of one currency in terms of a hypothetical basket of aggregated currencies is called an exchange rate
 - D) The prices of commodities are determined in the foreign exchange market.
 - E) The two types of exchange rate quotations are called biased and unbiased
- 23 Apart from the real rate of return, investors tend to care about the following two main characteristics of an asset:**
- A) Tangibility and payoff
 - B) Liquidity and tangibility
 - C) Risk and payoff
 - D) Risk and uncertainty
 - E) Risk and liquidity
- 24 Which of the following statements is correct?**
- A) The dollar rate of return on euro deposits is approximately the euro interest rate minus the rate of depreciation of the dollar against the euro
 - B) The law of one price is meant to explain why price levels are lower in poor countries
 - C) Departures from Purchasing Power Parity (PPP) are always similar in both short run and long run
 - D) Relative PPP is not valid when absolute PPP is not
 - E) The interest parity condition is the condition that the expected returns on any two currencies are equal when measured in the same currency
- 25 If the dollar interest rate is 6 percent per annum, the euro interest rate is 4 percent per annum, whereas the appreciation of the euro against dollar is 2 percent, then**
- A) an investor should invest in dollars
 - B) an investor should invest in euros
 - C) an investor should be indifferent between dollars and euros
 - D) an investor should invest neither in dollars, nor in euros
 - E) none of the above is correct
- 26 What is the dollar rate of return on euro deposits with today's exchange rate at \$1 per euro, next year's expected exchange rate at \$1,04 per euro and 5% dollar interest rate.**
- A) 6%
 - B) 1%
 - C) 9%
 - D) 10%

E) None of the above

27 Assume two countries, USA (Dollarland) and Germany (Euroland). A contractionary monetary policy in Germany causes

- A) an appreciation of dollar in the foreign exchange market
- B) an appreciation of euro in the foreign exchange market
- C) no effect on the dollar value in international markets
- D) a fluctuation of the euro value in international markets
- E) none of the above

28 Which one of the following statements is correct? (Refer to PUS as the prices in the US and YUS as the output in the US.)

- A) Given PUS and YUS, when the money supply rises, the dollar interest rate rises and the dollar depreciates against the euro
- B) Given PUS and YUS, when the money supply rises, the dollar interest rate declines and the dollar appreciates against the euro
- C) Given PUS and YUS, when the money supply decreases, the dollar interest rate declines and the dollar depreciates against the euro
- D) Given PUS and YUS, when the money supply decreases, the dollar interest rate rises and the dollar depreciates against the euro
- E) Given PUS and YUS, when the money supply rises, the dollar interest rate declines and the dollar depreciates against the euro

29 Assume a long run open economy model. Due to the improving outlook of the economy, people start to save less, which will cause

- A) an appreciation of the domestic currency
- B) a depreciation of the domestic currency
- C) a net capital outflow
- D) both A) and C)
- E) both B) and C)

30 Assume a short run open economy model under fixed exchange rates. An expansionary fiscal policy will

- A) increase the interest rate
- B) decrease net exports
- C) increase net capital inflows
- D) need to be accompanied by a “monetary accommodation”
- E) A), B) and C)

Part II (60 points):**Question 1 (30 points):**

Assume a standard trade model with two countries, two goods and two factors of production.

- (a) Explain by means of a graph the case of a biased growth. Show graphically and explain economically how and why the terms of trade are effected by a biased growth in one of the two countries. (16 points)
- (b) Show graphically and explain economically how and why the terms of trade are effected by an international income transfer. Explain verbally the Keynes-Ohlin controversy. (14 points)

Question 2 (30 points):

Assume an open economy in the long run under a flexible exchange rate regime and the standard assumptions as specified in the lecture.

- (a) Show graphically and explain economically the effects of a contractionary fiscal policy on the interest rate as well as the exchange rate, investments and net exports. (20 points)
- (b) Assume fixed exchange rate regime. What are the results of the above described policy? Answer the question using graphics and economic reasoning. (10 points)

End of the exam. Good luck!