

**Examination
for the lecture
“Introduction to International Economics” (11038)**

Preliminary Remarks:

- **Time:** 2 hours
 - **Aids:** no aids are allowed, except one 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 20 multiple choice questions (1-20) and part II consists of two questions (1, 2). In part I, all multiple choice questions are weighted equally. For each right question 3 points are given, for each wrong question 0 points are given. **There may be several right answers for each question.** A question is only correct if all right answers are marked. 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 mark the right answers with **X** in the table below. **Note that only the marking in the table below will count for the final grade.** Marks in the text will not be counted.

	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. The following Ricardo-type table shows the labor input required per unit of output in each of the two industries in each of the two countries:

	Shirts	Brandy
United States	4 days	12 days
France	6 days	12 days

Which of the following statements is correct?

- A) France's pretrade price ratio is 1 brandy = 2 shirts.
 B) The US pretrade price ratio is 1 brandy = 4 shirts.
 C) The US pretrade price ratio is 1 shirt = 1/3 brandy.
 D) The United States has a comparative advantage in shirts.
2. In the situation in Question 1 above, if the countries engage in trade at posttrade prices (terms of trade) of 1 shirt = 0.5 brandy, then .
- A) France gets all the gains from trade.
 B) The United States gets all the gains from trade.
 C) None of the countries gain from trade.
 D) The two countries share equally in the gains from trade.
3. The following Ricardo-type table shows the labor input required per unit of output in each of the two industries in each of the two countries. Suppose that Germany is a much larger country in terms of production and income than the United Kingdom. In this situation, other things equal, when the countries engage in trade, the posttrade price ratio (terms of trade) would tend to settle _____, and _____ would therefore tend to have relatively large gains from trade.

	Steel	Cloth
United Kingdom	4 days	8 days
Germany	6 days	9 days

- A) toward a value of 1 cloth = 2 steel; the United Kingdom
 B) toward a value of 1 cloth = 1.5 steel; the United Kingdom
 C) toward a value of 1 cloth = 1.5 steel; Germany
 D) toward a value of 1 cloth = 1.75 steel; both countries
4. In the Ricardo model, as a country moves from autarky to trade, the relative price of the country's import good will _____ for home consumers, and the relative price of the country's export good _____ for home consumers.
- A) fall; will rise
 B) fall; also will fall
 C) rise; also will rise
 D) fall; will not change

5. If relatively capital-abundant country A opens trade with relatively labor-abundant country B and the trade takes place in accordance with the Heckscher-Ohlin theorem, what would be the consequence for factor prices (w/r) in the two countries?
- A) (w/r) falls in B
 - B) (w/r) rises in B
 - C) (w/r) rises in A
 - D) (w/r) falls in A
6. Which of the following is NOT an assumption in the Heckscher-Ohlin analysis?
- A) increasing returns to scale
 - B) imperfect competition
 - C) identical production functions across countries
 - D) Factors are perfectly mobile within each country and completely immobile between countries.
7. In the Heckscher-Ohlin model of trade, the movement of a country from autarky to free trade generally results in _____ specialization in production, _____ the situation in the Ricardo model.
- A) complete; unlike
 - B) complete; as was also
 - C) partial; unlike
 - D) partial; as was also
8. In the Heckscher Ohlin model of trade, if a country's P_X/P_Y in autarky is less than the P_X/P_Y on the world market, then, as the country moves from autarky to trade, the relative price of good Y will _____ for home consumers. Thus, consumers with a strong relative preference for good _____ would tend to oppose the movement to trade.
- A) increase; Y
 - B) increase; X
 - C) decrease; Y
 - D) decrease; X
9. In the Heckscher Ohlin model of trade, if a country's P_X/P_Y in autarky is less than the P_X/P_Y on the world market, then this country has a comparative advantage in the _____ good, and, if the country now engages in international trade and moves along its production possibilities frontier, its production of the X good will _____.
- A) Y; increase
 - B) Y; decrease
 - C) X; not change
 - D) X; increase

10. In a Heckscher-Ohlin context, other things equal, growth of the relatively abundant factor of production in a country that is a "large" country will lead to _____ willingness to trade and to _____ in the country's terms of trade.
- A) an increased; a deterioration
 - B) an increased; an improvement
 - C) a decreased; a deterioration
 - D) a decreased; an improvement
11. In a Heckscher-Ohlin context, other things equal, growth of the relatively scarce factor in the large-country case will,
- A) decrease both exports and imports and lead to an improvement in the terms of trade.
 - B) expand exports and lead to a deterioration in the terms of trade.
 - C) expand imports and lead to an improvement in the terms of trade.
 - D) result in a decrease of imports and an improvement in the terms of trade.
12. If, at constant relative prices in a two-commodity and two-factor world, growth in a country's labor force causes an expansion in output of the labor-intensive good and a contraction in output of the capital-intensive good, this situation is an example of the
- A) Stolper-Samuelson Theorem.
 - B) Rybczynski Theorem.
 - C) Heckscher-Ohlin Theorem.
 - D) Leontief paradox.
13. If, when a country grows, its home production of its import good increases by 15 percent and its home consumption of the import good also increases by 15 percent, then, with the economic growth, the country's absolute quantity of imports will _____.
- A) increase
 - B) decrease by less than 15 percent
 - C) remain constant
 - D) increase by more than 10 percent
14. If a country has a current account deficit, which of the following may be true?
- A) $Y - (C + I + G) > 0$
 - B) $C - Y > 0$
 - C) $S - I > G - T$
 - D) $S < I + (G - T)$
15. In the ordinary analysis of IS and LM curves,
- A) expansionary fiscal policy shifts the IS curve to the left.
 - B) expansionary monetary policy shifts the LM curve to the right.
 - C) expansionary fiscal and expansionary monetary policy undertaken at the same time will lead to an increase in the level of equilibrium income.
 - D) expansionary fiscal policy and contractionary monetary policy acting together will lead to a decline in the equilibrium interest rate.

16. In the IS-LM analysis of a closed economy, an increase in the demand for money shifts the LM curve to the _____; other things equal, this will lead to _____ in the level of national income.
- A) right; an increase
 - B) right; a decrease
 - C) left; an increase
 - D) left; a decrease
17. In the IS-LM analysis, if the economy is located at a point that is to the left (or below) the IS curve and also to the left (or above) the LM curve, there is _____ pressure in the real sector of the economy as well as an excess _____ money.
- A) no; demand for
 - B) expansionary; supply of
 - C) contractionary; demand for
 - D) no; supply of
18. Suppose that country A with a flexible exchange rate undertakes expansionary monetary policy. Especially if short-term funds are extremely mobile between countries, A's currency will tend to _____ because of this policy, and this result suggests that A's monetary policy will be _____ effective in influencing national income than if A had a fixed exchange rate rather than a flexible exchange rate.
- A) appreciate; less
 - B) appreciate; more
 - C) depreciate; less
 - D) depreciate; more
19. In the IS-LM framework, which of the following statements is true?
- A) Fiscal policy is unambiguously more effective in influencing national income under flexible exchange rates than under fixed exchange rates.
 - B) Fiscal policy is unambiguously more effective in influencing national income under fixed exchange rates than under flexible exchange rates.
 - C) Monetary policy is unambiguously more effective in influencing national income under flexible exchange rates than under fixed exchange rates.
 - D) Monetary policy is unambiguously more effective in influencing national income under fixed exchange rates than under flexible exchange rates.
20. Expansionary aggregate demand-oriented fiscal policy leads to
- A) a short-run rise in income and a fall in the price level.
 - B) a short-run rise in income at a constant price level.
 - C) both an increase in the long-run equilibrium level of income and an increase in the price level.
 - D) no change in the long-run equilibrium level of income and to an increase in the price level.

Part II (60 points):

Question 1 (30 points):

A **large** country Home 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 good X how the subsidy affects prices, production and consumption as well as government revenue in Home and the welfare of the country as a whole. Use the concepts of consumer and producer surplus. Show and explain the reasons for the welfare effects. Additionally, discuss the effects of the subsidy on the world market (price and quantity). (24 points)
- (b) Is the size of the country relevant for the effects of the subsidy, and if so, why? Explain how the results in (a) would change for Home being a small country! (6 points)

Question 2 (30 points):

National money markets and foreign exchange markets are interlinked.

- (a) Show this link graphically, assuming money market equilibrium and interest rate parity. Stick to the short-run. Explain the link economically for a model setting with two countries (Home and Foreign). Interpret economically the two assumptions made. (14 points)
- (b) Assume that the money supply increases in Home. How does this affect the equilibrium combination of rates of return and the exchange rate in the short-run, and why? Use economic reasoning and graphical illustration(s) for your explanations. You may illustrate the effects in the graph from (a). (8 points)
- (c) Assume that the money demand decreases in Foreign. How does this affect the equilibrium combination of rates of return and the exchange rate in the short-run, and why? Use economic reasoning and graphical illustration(s) for your explanations. You are free to illustrate the effects using the graph from (a). (8 points)