Comprehensive economics excersises flashcard

Exam International Economics Academic Year 2011 -2012 Questions and Answers Question 1 Chapter 5 Suppose, as a result of various dynamic factors associated with exposure to international competition, Albania's economy grew, and is now represented by the rightmost product ion possibility frontier in the figure above. a) If its point of production with trade was point c, would you consider this growth to be export -biased or import biased? b) If Albania were a large country with respect to the world trade of A and B, how would this growth affect Albania's terms of trade and its real income?

Answer Question 1: a) If point c is the production point with trade, then Albania has a comparative advantage in good B. Therefore, from the shape of the new production possibility frontier (as compared to the original one), this is clearly an export-biased growth. 5 points b) This ceteris paribus would tend to worsen Albania's terms of trade. The terms of trade effect would, again ceteris paribus, worsen its real income. However, the growth itself acts in the opposite direction. 5 points Question 2 Chapter 17 Use a figure to explain the potential effectiveness of fiscal policy to spur on the economy under a fixed exchange rate.

Answer Question 2: With an aim toward increasing output, the government could use fiscal policy to shift the DD curve outward. The central bank will have to take steps to maintain a fixed exchange rate , among the options is buying foreign assets with money, to shift the AA schedule outward until the equilibrium at point 3 is reached. 5 points 10 points 1 Exam International Economics Academic Year 2011 -2012 Question 3 Chapter 6 Why are increasing returns to scale and fixed costs important in models of international trade and imperfect competition?

Answer Question 3: There are many answers. Three of these are a) Increasing returns to scale and high fixed costs may be inconsistent with perfect competition. In such a case, the initial autarkic state may be a suboptimal equilibrium. For example, relative prices may not equal marg inal rates of transformation. It follows from this that a change in output compositions associated with trade may result in a national welfare for one or both trading countries that is inferior to that associated with the initial autarkic conditions.

Hence no “ gains from trade. ” 3 points b) In a case of increasing scale economies at the firm or plant level, the determination of which product will be exported by which country is ex – ante indeterminate. Therefore, deriving clear implications concerning th e effects of trade on income distributions such as may be derived from the Samuelson -Stolper Theorem is no longer gen erally possible. 3 points c) Market structures containing positive scale economies and imperfect competition may allow for “ two -way trade,” or intra-industry trade. As in b. bove, the various theorems derivable from the Heckscher -Ohlin model concerning directions of trade and income distributions are no longer gen erally applicable. 3 points Question 4 Chapter 16 Find the real exchange rate for the following case: Assume that the representative basket of European goods costs 100 euro’s and the representative U. S. basket costs $125, and the dollar/euro exchange rate is $0. 75 per euro, then the price of the European basket in terms of U. S. basket is: ____ _____

Answer Question 4: [(0. 5 $/euro) (100 euro per a European basket)]/[(125 $/U. S. basket)] = 0. 60 U. S. baskets/European basket. 5 points Question 5 Refer to above figure. The loss of Consumer Surplus due to the tariff equals ________. Chapter 8 2 Exam International Economics Answer Question 5: [(100 x ($14 – $3))/2] – [(80 x ($14 – $6))/2] = $230 Academic Year 2011 -2012 5 points Question 6 Assuming relative PPP, fill in the table below: Chapter 15 Answer Question 6 Using ( )/ = ? US, t – ? E, t one gets: 5 points 3 Exam International Economics Academic Year 2011 -2012

Question 7 Chapter 10 a) Refer to above figure. If OmL1 workers are employed in manufacturing then what is the marginal productivity of labor in agriculture? b) Refer to above figure. Why would workers not shift from agriculture to manufacturing in the initial situation where wages are higher in the latter? Answer Question 7 a) OfWf. b) Imperfections in the labor market. 3 points 3 points Question 8 What can one learn from the following figure? Chapter 12 4 Exam International Economics Academic Year 2011 -2012 Answer Question 8 The figure shows the U. S. urrent account and net foreign wealth from 1977 until 2008. It shows that a string of current account deficits in the 1980s reduced America’s net foreign wealth until, by the end 2008, the country had accumulated a substantial net foreign debt. In 1987 the country became a net debtor to foreigners for the first time since World War I. 3 points Question 9 Chapter 14 a) Combine the graph showing the interest parity condition and one showing money demand and supply to demonstrate simultaneous equilibrium in the money market and the foreign exchange market.) How would an increase in the U. S. money supply affect the Dollar/Euro exchange rate and the U. S. interest rate? Illustrate your answer graphically and explain. Answer Question 9 a) Above the axis is depicted the foreign exchange market, where changes in the rate of return on the dollar are mapped into changes in the exchange rate. Below the axis is depicted the U. S. money market and shows the relation between the rate of return on the dollar and U. S. real money holdings. 10 points b) The mechanism works as follows.

Consider an increase in the U. S. real money holdings. Supply and demand dictate that the demand for money must increase, so the rate of return must lower to equilibrate at point 2. The lower rate of return on the dollar will cause the dollar to depreciate (exchange rate moves to point). 5 points 5 Exam International Economics Academic Year 2011 -2012 Question 10 Chapter 11 a) Refer to the above table. Suppose Airbus is set to produce the aircraft before Boeing. Which company will enter the market? b) Refer to the above table.

Suppose the U. S. government (but not Europe) offers a $10 million subsidy? 6 Exam International Economics Academic Year 2011 -2012 Answer Question 10 a) Airbus will produce and Boeing will not. 2 points b) In this case Airbus would decide not to enter the market since it knows Boeing will, and that therefore its own production will entail a loss of $5 million. 3 points Question 11 Chapter 14 Using a figure describing both the U. S. money market and the foreign exchange market, analyze the effects of an increase in the U.

S. money supply on the dollar/euro exchange rate. Answer Question 11: An increase in the U. S. money supply will cause interest rate to decrease. This should increase investment and possibly consumption of durable goods. The reduction in the interest rate will cause a movement to the left along the schedule depicting the expected euro return expressed in dollar. The result is an increase in E or a depreciation of the dollar. 15 points 7 Exam International Economics Academic Year 2011 -2012

Question 12 Indicate the effects of a permanent increase in the money supply. Chapter 16 Answer Question 12: 12 points 1) AA-shifts right-increase in Y and E both higher than if money supply change was temporary rising price level makes AD decrease, DD shifts left 2) Rising prices also reduce real money supply, so AA shifts left (although not all the way back to original position) 3) AA and DD reach short run equilibrium at an E that is higher than initially, but lower than the short run effects of the shift.) Output returns to initial level because higher prices reversed the effect of the initial depreciation on Aggregate Demand. Question 13 Chapter 7 Refer to above figure. The monopolist can export as much as it likes of its steel at the world price of $5/ton. How much steel will the monopolist sell, and at what price? Answer Question 13 It would sell 10 million tons at $5/ton. 3 points FINAL SCORE CALCULATION: (TOTAL SCOR ES / 13) x 1. 18 8