

Student: _____
Date: _____
Time: _____

Instructor: Demet Tunali
Course: Econ300_Summer08_01:220:300:H7
Book: Krugman/Obstfeld: International Economics 8e

Assignment: FinalExam_August13_08

1.

How do economies of scale give rise to international trade?

- A. International trade occurs because it increases the market size.
- B. International trade occurs because economies of scale transfer knowledge across countries.
- C. International trade occurs because of multi-national corporations.
- D. They enhance resource differences between countries.

2.

External economies of scale:

- A. tend to result in large profits for each firm and an industry with relatively few firms.
- B. lead to the creation of a single large monopoly.
- C. are more likely to be associated with a perfectly competitive industry.
- D. cannot be associated with a perfectly competitive industry.

3.

The concept "terms of trade" means

- A. the quantities of imports received in free trade.
- B. the price conditions bargained for in international markets.
- C. the amount of exports sold by a country.
- D. the price of a country's exports divided by the price of its imports.
- E. None of the above.

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4. If, beginning from a free trade equilibrium, the (net barter) terms of trade improve for a country, then it will

- A. increase consumption of its export good.
- B. increase production of its import competing good.
- C. increase the quantity of its imports.
- D. experience an export – biased shift in its production possibility frontier.
- E. None of the above.

5. International trade based on scale economies is likely to be associated with:

- A. comparative advantages associated with Heckscher-Ohlin factor-proportions.
- B. Ricardian comparative advantage.
- C. absolute advantages due to resource abundance.
- D. the law of diminishing returns.
- E. None of the above.

6. If the U.S. dollar depreciates in terms of the Euro:

- A. The relative price of U.S. exports would rise.
- B. European goods would be cheaper for Americans.
- C. American goods would be cheaper for Europeans.
- D. Americans would have to pay fewer dollars for one Euro.

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7.

An appreciation of a country's currency,

- A. lowers the relative price of its exports and raises the relative price of its imports.
- B. raises the relative price of its exports and raises the relative price of its imports.
- C. raises the relative price of its exports and lowers the relative price of its imports.
- D. decreases the relative price of its exports and lowers the relative price of its imports.
- E. None of the above.

8.

What is the "arbitrage" opportunity in the foreign exchange market?

- A. A cross-rate.
- B. A fee that brokers charge for trading currency of their clients.
- C. A difference between the exchange rates in different trading centers.
- D. A difference between the exchange rate for buying and selling the currency from the same bank.

9.

If a contract contains a promise that a specified amount of foreign currency will be delivered on the specified date in the future, this is:

- A. A foreign exchange option.
- B. A futures contract.
- C. A forward contract.
- D. A swap.
- E. A spot contract.

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10.

The following is an example of Radio Shack hedging its foreign currency risk:

- A. needing to pay 9,000 yen per radio to its suppliers in a month, Radio Shack makes a forward – exchange deal to buy yen.
- B. needing to pay 9,000 yen per radio to its suppliers in a month, Radio Shack makes a forward – exchange deal to sell yen.
- C. needing to pay 9,000 yen per radio to its suppliers in a month, Radio Shack buys yen at a spot – exchange 1 month from now.
- D. needing to pay 9,000 yen per radio to its suppliers in a month, Radio Shack sells yen at a spot – exchange 1 month from now.
- E. None of the above.

11.

If the dollar interest rate is 10 percent and the euro interest rate is 6 percent, then

- A. an investor should invest only in euros.
- B. an investor should be indifferent between dollars and euros.
- C. an investor should invest only in dollars.
- D. It is impossible to tell given the information.
- E. All of the above.

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12.

Which of the following statements about the arbitrage in the foreign exchange market is wrong?

- A. When $\$/\hat{\text{A}}\text{€} = \$/\hat{\text{A}}\text{€} * \hat{\text{A}}\text{€}/\hat{\text{A}}\text{€}$, triangular arbitrage is no longer profitable.
- B. When $\hat{\text{A}}\text{€}=1$ exchange for \$1, $\hat{\text{A}}\text{€}1$ exchanges for $\hat{\text{A}}\text{€}0.5$, and \$1 exchange for $\hat{\text{A}}\text{€}1$ there is room for profitable arbitrage.
- C. When $e^{\text{NY}} = 2.5\$/1\hat{\text{A}}\text{€}$ and $e^{\text{L}} = 1.5\$/1\hat{\text{A}}\text{€}$, you would buy pound deposits in New York and sell it in London.
- D. Arbitrage in the foreign exchange market refers to the process of taking advantage of exchange rate discrepancies to earn a profit.

13.

When the British $\hat{\text{A}}\text{€}$ depreciates against the U.S. \$

- A. The relative price of the British good increases
- B. For given forward exchange rate, short-term interest rates and expected $\$/\hat{\text{A}}\text{€}$ exchange rate, the demand for pound deposits decreases
- C. The opportunity cost of the American good increases
- D. All of the above

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14.

Suppose that the Manhattan Classic Car Club imported 1995 Aston Martin Virage for $\tilde{A}, \hat{A}£46,000$. While the importer currently holds the \$ equivalent of the car's price, the payment will occur at the time of delivery in three months from now. Suppose also that current interest rates on pound and dollar denominated deposits for six months are 3% and 2% respectively and the current spot exchange rate is $2\$/1\hat{A}£$. Assume also that the holder of the club is anxious about the exchange rate it would face in 30 days thus he doesn't want to bear the foreign exchange risk. Which action would be to his best interest.

- A. holding dollars if the future spot rate is $2.7\$/1\tilde{A}, \hat{A}£$.
- B. holding pounds if the future spot rate is $1\$/1\tilde{A}, \hat{A}£$.
- C. buy pounds at the forward market if it sells at a 2% discount
- D. buy pounds at the forward market if it sells at a premium

15.

As opposed to our assumption, if an increase in the money supply raises real output in the short run,

- A. Domestic prices will fall temporarily
- B. The temporary higher production would further lower the interest rate in the short run
- C. The exchange rate would exceed its long run level much less
- D. None of the above

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16. A increase in the number of households is known to permamnetly increase the aggregate money demand function of an economy. Other things being equal, this would lead to
- A. a permanent increase in the interest rate
 - B. to an overshooting of the exchange rate in the short run
 - C. an expected appreciation of the domestic currency
 - D. A and C

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17.

The *Economist* magazine is famous for its publication of the Big Mac index -- a table of Big MacTM prices in different countries around the world. The use of the Big Mac allows for a highly standardized product sold throughout the world. Given the following abbreviated table:

Country	Price _{Big Mac}
China	Rb 10,000
U.K.	£2
U.S.	\$1.25

An individual merchant of a given country is small enough and thus takes the market price of a Big Mac as given. Suppose that the exchange rate between China and the U.S is:

$$\text{Rb (Rembini) } 10,000 = \$1.00$$

Suppose also that the exchange rate between China and the U.K is:

$$\text{Rb (Rembini) } 16,000 = \text{£}1.00$$

The transportation cost of a BigMac between China and London is £.25, while that between China and U.S. is \$.50.

Which of the following statement is true?

- A. A U.S. merchant with \$1000 would make a profit of \$.25 per Big Mac by buying it from China and selling in New York.
- B. A Big Mac is cheaper in China than both in U.K and U.S.
- C. It would not pay to ship Big Mac from China to London
- D. A and B

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18.

What does the relative purchasing power imply?

- A. If the Law of One Price holds for all the goods, the absolute PPP will always hold unambiguously.
- B. That an increase in a country's purchasing power will be associated with a proportional depreciation of its currency.
- C. The real exchange rate is 0.
- D. the expected real interest rate differential is zero.
- E. All of the above

19.

Suppose U.S. imposes tariff on the import of toys from China. Without a change in the monetary conditions of each countries, this would lead to

- A. a real appreciation of the U.S. \$
- B. nominal appreciation of the U.S. \$
- C. A and B
- D. a constant expected real interest rate.
- E. A and D

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20.

Studies show that the credit card use in the United States permanently and dramatically reduced household demand for checking accounts. If the purchasing power parity holds, this would lead to

- A. an expected increase in real interest rate.
- B. a nominal depreciation of the U.S. \$
- C. a real appreciation of the U.S. \$
- D. None of the above

21.

Which of the following statement is consistent with the monetary approach to the exchange rate?

- A. In the short run, a fall in the money supply level of a country will lead to a an appreciation of its currency more than its long run level.
- B. a fall in a country's nominal interest rate associated with a lower expected rate of inflation leads to the domestic currency appreciation.
- C. a rise in the relative demand of a country's good would lead to a real depreciaition of its currency
- D. A and B

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22.

The *Economist* magazine is famous for its publication of the Big Mac index -- a table of Big MacTM prices in different countries around the world. The use of the Big Mac allows for a highly standardized product sold throughout the world. Given the following abbreviated table:

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An individual merchant of a given country is small enough and thus takes the market price of a Big Mac as given. Suppose that the exchange rate between China and the U.S is:

$$\text{Rb (Rembini) } 10,000 = \$1.00$$

Suppose also that the exchange rate between China and the U.K is:

$$\text{Rb (Rembini) } 5,000 = \text{£}1.00$$

The transportation cost of a BigMac between China and London is £.25, while that between China and U.S. is \$.50.

Which of the following statements about the absolute purchasing power parity (APPP) is correct?

- A. Ignoring transportation costs, APPP predicts that Chinese Rembini should appreciate against the U.S. dollar.
- B. APPP holds between £ and \$.
- C. British pound is overvalued compared to its long run level.
- D. None of the above

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23.

Which of the following statement about the real exchange rate is true?

- A. the real exchange rate absorbs the deviations from the PPP.
- B. the effects of all non-monetary shocks on the real exchange rate lead to similar predictions with that of PPP.
- C. if a foreign country's productivity increase in traded goods sector falls behind that of the domestic country, the real exchange rate of the domestic country would fall.
- D. A and C.

24.

If a small country were to levy a tariff on its imports then this would

- A. decrease the country's economic welfare.
- B. change the terms of trade.
- C. have no effect on that country's economic welfare.
- D. increase the country's economic welfare.
- E. None of the above.

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25.

Suppose that a developing country fixes the amount of its currency's nominal depreciation against the dollar. What would happen if the developing country's price level rises faster than that of U.S.? (Hint: Think about the definition of the real exchange rate and express it in the form of changes rather than level).

- A. The developing country's currency appreciates in real terms.
- B. Developing country's goods and services get cheaper relative to U.S. goods and services.
- C. The relative demand for U.S. goods fall.
- D. The developing country's currency remains constant in real terms.
- E. B and D

26.

Suppose that the money supply is initially constant in a country. When, to curb inflation, there is a permanent fall in the money supply, what happens in the short run? (Hint: First remember what happens to the nominal interest rate and the expected inflation. Then consider the reflection of these on real variables.)

- A. Due to the money neutrality, the real exchange rate remains constant.
- B. The real interest rate increases more than the nominal interest rate.
- C. The country's currency is expected to depreciate.
- D. B and C.

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27.

Assume that the interest parity hold. If the expected real interest rate in the United States is 9% and the expected real interest rate in Europe is 3%.

- A. The relative demand for U.S. goods is expected to fall
- B. there is an expectation that the real dollar/euro exchange rate will appreciate
- C. A and B
- D. None of the above

28.

How many dollars would it cost to buy an Edinburgh Woolen Mill sweater costing 50 British pounds if the exchange rate is 1.50 dollars per one British pound?

- A. 50 dollars
- B. 60 British pounds
- C. 75 dollars
- D. 62.5 dollars
- E. 40 British pounds

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29. What is the pound price of dollars if a pair of American jeans costs 60 dollars in New York and 30 Pounds in London?

- A. 1.5 British pounds per dollar
- B. 0.5 dollars per British pound
- C. 2 British pounds per dollar
- D. 3.5 dollars per British pound
- E. 1/2 dollars per British pound

30. Suppose the return on a European bond is 6 percent per year. If we expect the euro to depreciate with respect to the U.S. dollar euro by 4% in the next year and an inflation rate of 1.5% in U.S., what is the expected real dollar return on this European bond?

- A. 2 percent
- B. 8 percent
- C. 10 percent
- D. 0.5 percent

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31.

Given the following data:

$$E_t = ¥100 = \$1.00$$

$$E_{t+1} = ¥150 = \$1.00$$

$$i_{U.S.} = 8\%$$

What is the Yen return on a dollar deposit.

- A. 14.66%
- B. 50%
- C. 58%
- D. -58%

32.

A weighted average tariff is computed weighting each industry's tariff rate by that industry's share of total imports. Suppose that a country imports \$40mn worth of good X and \$80mn worth of good Y. The tariff rates on X and Y are 30% and 45% respectively. Then the weighted average tariff for the country is

- A. 30
- B. 27
- C. 40
- D. 47

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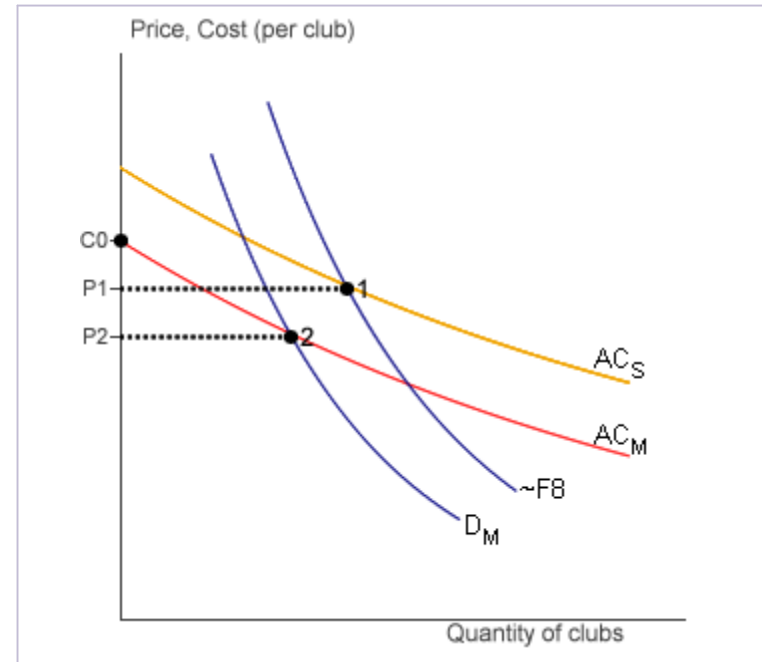
33. Which of the following statement is true?

- A. The possibility that tariffs might have perverse effects on internal prices of a country is known as the Meltzer paradox
- B. European subsidies on all types of agricultural exports hurts U.S. corn exporters.
- C. European tariffs on steel imports from China benefits U.S. steel importers.
- D. All of the above

34. The figure to the right shows curves representing the average cost of golf clubs produced in Scotland and Malaysia as well as the Malaysian and the world demand for golf clubs.

Assuming that Scotland's historical association with golf led it to first manufacture golf clubs, this figure indicates that

- A. Malaysia will import clubs from Scotland
- B. Malaysian producers and players would both benefit from banning the imports.
- C. Malaysian producers can initially produce clubs at loss
- D. A and C
- E. All of the above



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35.

External economies of scale arise when the cost per unit

- A. rises as the industry grows larger.
- B. falls as the industry grows larger and rises as the average firm grows larger.
- C. falls as the average firm grows larger.
- D. falls when the monopoly profits apply.
- E. B and D

36.

The table to the right gives the employment share of four industries within the three regions of a country.

Which, if any, of these industries would you classify as non-tradable?

- A. Industries A and B
- B. Industries C and D
- C. Industry A
- D. Industry D
- E. Industry B

	Industry			
	A	B	C	D
East	1%	4%	7%	23%
Central	17%	5%	8%	22%
West	2%	21%	7%	24%

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37. If the dollar interest rate is 10 percent, the euro interest rate is 6 percent, and the expected return on dollar depreciation against the euro is 4 percent, then

- A. an investor should invest only in dollars.
- B. an investor should be indifferent between dollars and euros.
- C. an investor should invest only in euros.
- D. It is impossible to tell given the information.
- E. All of the above.

38. Which of the following economic agents would tend to support the depreciation of the domestic currency

- A. Import-competing sectors
- B. Domestic consumers as this lowers the opportunity cost of the foreign goods
- C. Firms that use imported inputs
- D. A and B

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1. A
2. C
3. D
4. C
5. E
6. C
7. C
8. C
9. B
10. A
11. D
12. C
13. C
14. D

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- 15. C
- 16. C
- 17. B
- 18. D
- 19. C
- 20. B
- 21. D
- 22. A
- 23. D
- 24. A
- 25. A
- 26. B
- 27. D
- 28. C

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- 29. E
- 30. D
- 31. C
- 32. C
- 33. D
- 34. E
- 35. B
- 36. B
- 37. B
- 38. A