**International Finance, Fall 2023**

**Final Examination**

**INSTRUCTIONS**

* READ THE INSTRUCTIONS CAREFULLY!
* CLOSED BOOKS, NO NOTES
* Write your name on the exam. If you use more than one sheet of paper, write your name on each sheet and numerate them.
* Write legibly.
* **Don’t write too much.** Brief and complete answers will receive a higher score than long answers which include the right elements but have also plenty of things that have nothing to do with the question being asked. When you answer a question, just answer the question; don’t narrate the history of the universe. Most questions can be answered with a couple of sentences.
* Your grade will be your total score divided by 5.5

1. Consider an economy with wage rigidity and a fixed exchange rate like the one studied in Chapter 10 of the textbook. (3 points for each sub question)
   1. Under which conditions would capital controls be useful for this economy? Explain the economic mechanism (a simple graph might help). How should capital controls be implemented?
   2. Now assume that wages and prices are fully flexible, would capital controls still help? Would they make things worse? If so why. If not why not.
   3. What are the main differences in terms of welfare between imposing capital controls and adopting an optimal exchange rate policy?
   4. What about the difference between adopting an optimal exchange rate policy and a wage subsidy?
2. Consider a model in which a country receives an endowment with and iid (2 points for each sub question, you can answer the first 5 points with a simple graph/equation)
   1. What is the country’s consumption path under the assumptions that the country can issue state contingent debt and can commit to repay?
   2. What is the country’s consumption path under the assumptions that the country can issue state contingent debt and cannot commit to repay and suffers no consequence if it defaults?
   3. What is the country’s consumption path under the assumptions that the country can issue state contingent debt and cannot commit to repay but loses part of its output if it defaults?
   4. What is the country’s consumption path under the assumptions that the country can issue state contingent debt and cannot commit to repay and loses market access forever if it defaults?
   5. What is the country’s consumption path under the assumptions that the country cannot issue state contingent debt and cannot commit to repay and loses market access if it defaults? (use the assumptions and prediction of the quantitative model discussed in class to answer this question)
   6. What is the main factor driving the difference between your answers to points (c) and (d)?
3. One of the key feature of business cycles in both emerging and advanced economies is that the trade balance and the current account are countercyclical.
   1. The first model that we studied in class finds procyclicality in the current account and trade balance. Provide an economic interpretation for this result. (3 points)
   2. Briefly describe three possible strategies for building models that produce countercyclical trade and current account balances. What role do consumption and investment play in driving countercyclicality in these three strategies? (9 points)