GEB 3373 Homework 6

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> All uncited quotes are from the textbook

Chapter 8

> 1. What determines the demand for any given currency in the foreign-exchange market?

- "Like the prices of other commodities, the price of foreign exchange—given a flexible exchange rate system—is set by demand and supply in the marketplace." For example, the demand curve for Japanese Yen is called the *derived demand* curve "because the demand for yen is derived from foreigners' desire to acquire Japanese goods, services, and assets."

> 2. What determines the supply of any given currency in the foreign-exchange market?

- Carrying the Japanese example from question 1: "Underlying the supply curve for yen is the desire by the Japanese to acquire foreign goods, services, and assets. To buy foreign products, the Japanese need to obtain foreign currencies, which they do by selling yen and using the proceeds to buy the foreign currencies. Selling yen has the effect of supplying yen to the foreign-exchange market."

> 3. How are prices established in the foreign-exchange market?

- The price of any given currency is dictated by the supply and demand for it in the foreign-exchange market.

> 4. What is the role of international banks in the foreign- exchange market?

- " International banks also play a key role in the retail market for foreign exchange, dealing with individual customers who want to buy or sell foreign currencies in large or small amounts."

> 5. Explain the different techniques that firms can use to protect themselves from future changes in exchange rates.

- "Currencies can be bought and sold for immediate delivery or for delivery at some point in the future. The **spot market** consists of foreign-exchange transactions that are to be consummated immediately. [...] The **forward market** consists of foreign-exchange transactions that are to occur sometime in the future. [...] A **swap transaction** is a transaction in which the same currency is bought and sold simultaneously, but delivery is made at two different points in time."

> 6. Discuss the major types of arbitrage activities that affect the foreign-exchange market.

- "**Arbitrage** is the riskless purchase of a product in one market for immediate resale in a second market to profit from a price discrepancy."

- **Arbitrage of Goods**: "Under the *law of one price*, such arbitrage activities will continue until the price of the good is identical in both markets (excluding transactions costs, transportation costs, taxes, and so on)."
- **Arbitrage of Money**: There are two main forms, two-point and three-point arbitrage. The former, "also called **geographic arbitrage** , involves profiting from price differences in two geographically distinct markets." "Three-point arbitrage is the buying and selling of three different currencies to make a riskless profit."

> 7. Describe the various forms a bank's overseas operations may take.

- "A **correspondent relationship** is an agent relationship whereby one bank acts as a correspondent, or agent, for another bank in the first bank's home country, and vice versa."
- **Subsidiary bank**: "Separately incorporated overseas banking operation."
- **Branch bank**: "Overseas banking operation of a home country bank that is not separately incorporated."
- **Affiliated bank**: "Partly owned, separately incorporated overseas banking operation of a home country bank."

> 8. What are Eurocurrencies?

- **Eurocurrencies**: "Currency on deposit in banks outside its country of issue."

> 9. What are the major characteristics of offshore financial centers?

- Political stability
- "a regulatory climate that facilitates international capital transactions"
- "excellent communications links to other major financial centers"
- "availability of legal, accounting, financial, and other expertise needed to package large loans"

Chapter 9

> 1. What is fair trade? Who benefits from it?

- "**Fair trade**, sometimes called **managed trade** , suggests that the national government should actively intervene to ensure that domestic firms' exports receive an equitable share of foreign markets and that imports are controlled to minimize losses of domestic jobs and market share in specific industries. Some fair traders also argue that the government should ensure a "level playing field" on which foreign and domestic firms can compete on equal terms."

> 2. What is the infant industry argument?

- **Infant industry argument**: "Argument in favor of governmental intervention in trade: a nation should protect fledgling industries for which the nation will ultimately possess a comparative advantage."

> 3. What are the different types of tariffs?

- "An **ad valorem tariff** is assessed as a percentage of the market value of the imported good."
- "A **specific tariff** is assessed as a specific dollar amount per unit of weight or other standard

measure."
- "A **compound tariff** has both an ad valorem component and a specific component"

> 4. Why is it useful for an importer to seek out an advance tariff classification from the U.S. Customs Service?

- If a business does not properly account for customs costs, they can lose a lot of money. By getting this number in advance, they can price their good or service accordingly.

> 5. Why might a country adopt a VER?

- A company might adopt a *voluntary export restraint* because they are getting bad press in the target country's markets such as when Japan placed a VER on US bound automobiles after Toyota received bad press for taking jobs away from Americans.

> 6. What are the major forms of NTBs?

- "A **quota** is a numerical limit on the quantity of a good that may be imported into a country during some time period, such as a year."
- "A **voluntary export restraint (VER)** is a promise by a country to limit its exports of a good to another country to a prespecified amount or percentage of the affected market."
- Product and testing standards
- Restricted access to distribution networks
- Public-sector procurement policies
- Local-purchase requirements
- Regulatory controls
- Currency controls
- Investment controls

> 7. What is an FTZ?

- "A **foreign trade zone (FTZ)** is a geographic area in which imported or exported goods receive preferential tariff treatment. An FTZ may be as small as a warehouse or a factory site (such as Caterpillar's diesel engine facility in Mossville, Illinois) or as large as the entire city of Shenzhen, China (which neighbors Hong Kong)."

> 8. What is the role of the Eximbank?

- "The **Export-Import Bank of the United States (EXIM Bank)** provides financing for U.S. exports through direct loans and loan guarantees"

> 9. What is the purpose of a CVD?

- "A **countervailing duty (CVD)** is an ad valorem tariff on an imported good that is imposed by the importing country to counter the impact of foreign subsidies."

> 10. What are the two definitions of *dumping*?

- "There are two types of dumping. **Dumping** can occur when a firm sells its goods in a foreign market at a price below what it charges in its home market. This type of dumping is a form of international price discrimination. The second type of dumping involves the firm’s selling its goods below cost in the foreign market, in which case the dumping is a form of predatory pricing."