1. Last year Bulgaria’s aggregate output (Y) exceeded its aggregate Expenditures (E) on goods and services.
2. Bulgaria must have been in a recession
3. Bulgaria must have had a trade balance deficit
4. Bulgaria must have had a trade balance surplus
5. the Bulgaria Central Bank must have been ‘sterilizing.’
6. The Ricardian theory of comparative advantage states that a country has a comparative advantage in wheat if
7. output per worker of wheat is higher in that country than other countries.
8. wages in the wheat sector are low compared to other countries.
9. wheat is produced at lower opportunity cost compared to other countries.
10. Wheat is land-intensive and the country has a lot of land.
11. A country’s pattern of trade is determined by comparative advantage. If however a country has an absolute dis-advantage at producing both goods compared to its trading partners we would predict that that country
12. would run a trade deficit
13. would run a trade surplus
14. has a lower equilibrium wage rate
15. has a higher equilibrium wage rate
16. According to the Ricardian model, a nation engaged in trade will choose a consumption bundle
17. on its production possibilities frontier.
18. inside its production possibilities frontier.
19. outside its production possibilities frontier, on its consumption possibility frontier.
20. inside its trade-partner's production possibilities frontier.
21. The Hecksher-Ohlin-Samuelson model focuses primarily on what as the source of comparative advantage across countries?
22. differences in tastes
23. differences in technology
24. differences in factor endowments
25. none of the above
26. Proponents of free trade claim all of the following as advantages of trade *except*
27. a wider selection of products for consumers
28. increased competition amongst world producers.
29. the utilization of more efficient production processes.
30. higher wage levels for all domestic workers
31. If a very small country opens to trade with a very large country then according to the Ricardian model
32. the small country suffers a decrease in economic welfare.
33. the large country suffers a decrease in economic welfare.
34. the small country will enjoy larger gains from trade.
35. the large country will enjoy larger gains from trade.
36. Home is a small country. Foreign is a very large country.   
    Unit Labor Requirements (hrs work/unit output)

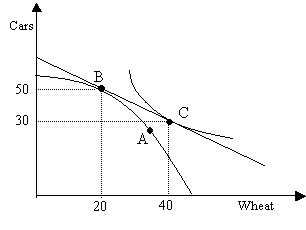
Cloth Widgets

Home 10 20

Foreign 12 6

1. Neither country has a comparative advantage.
2. Home has a comparative advantage at both products.
3. Home has a comparative advantage at cloth.
4. Home has a comparative advantage at widgets.
5. The opportunity cost of producing a unit of cloth, measured in terms of widgets, is \_\_\_\_\_\_\_\_ in Home and \_\_\_\_\_\_\_\_ in foreign.
6. 10/12, 20/6
7. 6/20, 12/10
8. ½ (=10/20), 2 (=12/6)
9. 2 (=20/10), ½ (=6/12)
10. If Home were able to improve its technology to cut its unit labor requirements in each sector in half (to 5 for cloth and 10 for widgets) then, Home’s comparative advantage would
11. remain the same and real wages would double.
12. remain the same and real wages would be unchanged.
13. reverse and real wages would be cut in half
14. reverse and real wages would be unchanged.
15. By definition, a “capital abundant” country
16. Has a lot of capital, compared to other countries
17. Has a small labor force, compared to other countries
18. Has a lot of capital relative to labor, compared to other countries
19. Has more modern technology compared to other countries.
20. Chinese workers’ wages are much lower than US workers’ wages. To be able to compete, US workers’ must have a labor productivity advantage that matches or exceeds this wage differential. In practice, why might US labor productivity exceed that of Chinese workers?
21. The US has more capital per worker
22. The US has better infrastructure (roads, ports, legal systems, etc)
23. US workers have on average more years of education
24. All of the above
25. Intra-industry trade is most common in the trade between
26. developing countries of Asia and Africa.
27. industrial countries of Western Europe and North America.
28. capital abundant and Labor abundant countries.
29. formerly communist nations.

The picture that follows depicts the production possibility curve (PPC) for HOME which has a capital-intensive Wheat sector and a labor-intensive Car sector. Both factors (labor, land) are assumed perfectly mobile across sectors. Without trade production and consumption would be at A. The world price line is drawn tangent to the PPC at B.



1. When the country opens to trade, the relative price of land-intensive Wheat (measured in terms of cars) \_\_\_\_\_\_, leading producers to \_\_\_\_\_\_ output of Wheat.
2. falls, cut back
3. falls, increase.
4. increases, cut back
5. increases, increase
6. By the Stolper-Samuelson Theorem, this price change should lead wages to \_\_\_\_\_\_ relative to the rental rate of capital.
7. rise
8. fall
9. rise in the wheat sector and fall in the car sector
10. rise in the wheat sector and fall in the car sector
11. With Trade, Home will produce at point \_\_\_\_\_\_ and consume at point \_\_\_\_\_\_\_.
12. B; C
13. A; B
14. C; A
15. B; B
16. Home will export \_\_\_\_\_\_\_ and import \_\_\_\_\_\_\_\_\_\_\_\_.
17. 20 Tons of wheat; 20 Cars
18. 50 Cars; 20 tons of wheat
19. 30 Cars; 40 tons of wheat
20. 20 Cars; 20 tons of wheat
21. From the diagram we can also infer that the new world price is
22. 1 car per ton of wheat
23. 1/2 car per ton of wheat
24. 50 cars per 20 tons of wheat
25. 30 cars per 40 tons of wheat
26. The U.S. Current Account Deficit for 2004 is expected to be about 670 billion dollars, or about 5.6 percent of US GDP. Last week Federal Reserve Chairman Alan Greenspan expressed concern over this. What was he *most likely* concerned about?
27. Large trade and current account deficits will raise total unemployment as imports lead to job losses.
28. A large deficit puts pressure on the dollar to appreciate, causing inflation that the Fed wants to avoid.
29. If foreigners’ willingness to buy US assets to finance the deficit weakens, adjustment may require a sharp depreciation of the dollar and/or rising interest rates.
30. The large deficit means the US has been a net lender to the rest of the world, and if other countries default taxes may have to rise.
31. In his comments Alan Greenspan also stressed the importance of fiscal discipline in adjusting the current account deficit. Fiscal discipline would help because it would
32. reduce the large amount of US lending abroad.
33. lower unemployment, reducing the CA deficit.
34. allow private domestic spending to grow, lowering imports and the trade deficit.
35. increase net national savings, which would lower the trade and current account deficit.
36. If the floating peso-dollar exchange rate moves from 3 pesos per dollar to 2 pesos per dollar, then the peso has \_­\_\_\_\_\_\_\_ relative to the dollar.
37. converged
38. sterilized
39. appreciated
40. depreciated
41. If the Central Bank neither buys nor sells foreign exchange (so official reserve transactions, ORT, remain at zero) then the country must be
42. running a balance of payments (BoP) deficit and fixing the exchange rate
43. floating the exchange rate, and the BoP will be balanced
44. maintaining a crawling exchange rate
45. experiencing a speculative attack.
46. According to the theory of covered interest rate parity, if US annual interest rates are observed to be 2% higher than British interest rates on similar assets it must be because markets expect
47. the dollar to appreciate by 2% relative to the pound
48. the dollar to depreciate by 2% relative to the pound
49. The Bank of England to raise British interest rates.
50. The Bank of England to lower British interest rates.
51. Suppose Mexico maintains a *floating* exchange rate. The Mexican peso is trading at 7 pesos to one US dollar. Suppose that new political instability leads investors to take investments out of Mexico. This will likely
52. Lead to a depreciation of the peso
53. Lead to a loss of Central Bank Reserves
54. Worsen the balance of payments deficit
55. All of the above
56. Evaluate the following advice: "To prosper and grow countries should always strive to run trade and current account surpluses.”
57. True, because countries that run deficits accumulate debts that slow output growth.
58. True, because imports cause unemployment
59. False, a current account deficit reflects a high level of saving by domestic residents.
60. False, a current account deficit may reflect borrowing from abroad or foreign direct investment for productive investments.

*Starting January 1, 2004 the Central Bank of Paraguay had 5 billion US dollars of foreign exchange reserves. It pegs the exchange rate at 100 pesos per US dollar. That means it had 500 billion pesos of international reserves as assets. The Bank also held 100 bn pesos worth of Paraguayan Treasury Bills (DC). The Monetary Base (H) in this economy was therefore 600 bn pesos and the Central Bank’s balance sheet was as follows:*

|  |  |  |  |
| --- | --- | --- | --- |
| **Assets** | | **Liabilities** | |
| e R | 500 bn pesos | H | 600 bn pesos |
| DC | 100 bn pesos |  |  |

*During the course of 2004 Paraguay had the following transactions on the current account (CA), the capital account (KA) and official reserve transactions (ORT).*

|  |  |  |
| --- | --- | --- |
| **CA** | **KA** | **ORT** |
| -2 billion US$ | +1 billion | + 1 billon US$ |

1. What kind of items would be associated with credits on the capital account (KA)?
2. Paraguayan leather exports.
3. American tourists spending money in Paraguay
4. Paraguayans investing in the US Stock exchange.
5. US citizens investing in the Paraguayan stock exchange.
6. What was Paraguay’s balance of payments (BoP) deficit or surplus in 2004?
7. 2 billion dollar deficit
8. 1 billion dollar deficit
9. 1 billion dollar surplus
10. 2 billion dollar surplus
11. From the figures in the table what can we infer about the rise or fall in the level of Central Bank reserves in 2004?
12. They remained unchanged
13. They rose 1 billion US$
14. They fell 2 billion US$
15. They fell 1 billion US$
16. If we assume that Domestic Credit (DC) remained unchanged, what would have happened to the monetary base (H) and interest rates in 2004?
17. Monetary base and interest rates unchanged.
18. Monetary base up 5 billion pesos, interest rates fall
19. Monetary base down 5 billion pesos, interest rates fall
20. Monetary base down 5 billion pesos, interest rates rise

*The partial equilibrium diagram below depicts domestic equilibrium output and imports of Light Bulbs. The free trade world price is 20 cents per light bulb. The country imposes a 50% ad-valorem tariff that raises the domestic (tariff-inclusive) price to 30 cents per bulb.*

Domestic  
Supply

Price  
(in cents)

40

World Price

Tariff inclusive price

H

G

30

E

D

A

C

B

20

Demand

20

40

50

30

10

Light Bulbs (million)

1. With free trade (no tariff) domestic demand will be \_\_\_\_\_\_\_ bulbs and imports \_\_\_\_\_
2. 40, 20
3. 30, 0
4. 40, 20
5. 50, 40
6. At a tariff-inclusive price of 30 cents per bulb, domestic demand will be \_\_\_\_\_\_\_ bulbs and imports \_\_\_\_\_
7. 40, 20
8. 30, 0
9. 40, 20
10. 50, 40
11. The consumer loss from imposing the tariff is:
12. G + H
13. B + E
14. A + B + C + D + E
15. C + D
16. Tariff revenue from imposing the tariff is:
17. G + H
18. A
19. B + C + D + E
20. C + D
21. Triangle B can be interpreted as:
22. The increase of tax revenue to the government from higher domestic production and employment.
23. The cost of the additional rent-seeking that emerges due to the increase of tariff revenue.
24. The opportunity cost of the additional resources the economy uses to increase domestic output.
25. The loss of consumer surplus due to consumption that no longer takes place with a tariff imposed.
26. If improved technology allowed domestic bulb producers to slightly lower their marginal cost of production at any given output, the expected equilibrium impact on the diagram above is
27. increased consumption at a lower market price.
28. increased domestic production, less imports, lower price.
29. increased domestic production, less imports, same price.
30. lower domestic demand, higher imports.
31. If the exchange rate is 10 pesos per dollar, what is the dollar value of one peso?
32. 10 dollars
33. 10 cents
34. 1 cent
35. 1 dollar
36. We are in Mexico. The demand curve for foreign exchange (dollars) slopes down (demand for dollars increases as the peso price of a dollar falls) because:
37. At lower exchange rates foreign-priced goods look cheaper to Mexican residents, so imports rise.
38. At a higher exchange rate the home currency can buy more foreign goods.
39. The quantity of dollars supplied rises as the exchange rate falls.
40. The Central Bank buys currency whenever it gets cheap.
41. Suppose the nominal exchange rate in Mexico is *e* = 10 pesos/US$ and the price of a Big Mac hamburger at MacDonalds in the United States is $3.50. Then according to the law of one price a Big Mac in Mexico should cost exactly
42. 3.50 pesos
43. 350 pesos
44. 35 pesos
45. 3.5 times the hourly wage of a Mexican laborer
46. In practice the price of a Big Mac in Mexico City often differs from the price of a Big Mac in the United States. The most likely explanation is that
47. Mexicans are poorer than Americans, so MacDonald’s sets a lower price in Mexico City.
48. A Big Mac is not a pure tradable good, much of its price depends on non-tradable inputs whose price does not equalize across borders.
49. Most years Mexican inflation exceeds US inflation
50. Mexicans prefer tacos to hamburgers.
51. A country is pegging (fixing) its nominal exchange rate (*e*  measured in pesos per dollar). Yet its real exchange rate may be appreciating? How?
52. If domestic inflation exceeds foreign inflation.
53. If foreign price inflation exceeds domestic inflation
54. If speculators are mounting a speculative attack on the peso.
55. If absolute PPP holds.
56. The largest borrower in the world in the past decade has been
57. The developing countries
58. The Middle East
59. The United States
60. The former Soviet Union.

1. If a country finds itself in a ‘debt overhang’
2. It needs to devalue to quickly relieve pressure on its domestic debtors.
3. It needs to sterilize the automatic adjustment mechanism until total debt has been reduced to manageable levels.
4. It is at a point where the consequence of default on its entire debt is preferable to continued repayment.
5. Its creditors may recover more if they act together to offer concerted debt relief.
6. A domestic monopolist facing import competition
7. Prefers a tariff to its equivalent quota
8. Prefers a quota to its equivalent tariff
9. Is indifferent between a tariff and a quota
10. Prefers free trade
11. George Soros
12. Is a famous trade economist who gave us the theory of intra-industry trade.
13. Is a famous currency trader who got rich speculating against the British pound
14. Is a famous shipping magnate, who led a transport revolution that greatly expanded trade.
15. Is the current head of the IMF.
16. A decrease in the money supply is most likely to have which of the following effects:
17. raise interest rates, attracting foreign investment, improving the capital account
18. lower spending, lowering imports and improving the current account
19. Slow inflation, or possibly even lower prices, improving the cost competitiveness of export sales abroad, improving the current account
20. All of the above
21. Which tends to result in greater national welfare loss for the home economy, an import quota or a voluntary export quota (or Voluntary Export Restraint) set at the same level but imposed by the foreign government?
22. the import quota.
23. the voluntary export quota
24. they are exactly equivalent
25. none of the above
26. Comment on the following: “Since tariff protection leads to deadweight losses then joining a custom union can only raise national welfare because it removes some of those distorting tariffs.”
27. Always true so long as tariffs create deadweight loss.
28. Only true if ‘trade creation’ effects exceed ‘trade diversion’ effects.
29. Only true if effective rates of tariff protection exceed nominal rates
30. Only true if the ‘MFN’ effect of tariff reduction does not exceed the deadweight loss recovered.
31. An import tariff can be interpreted as
32. A tax on both production and consumption.
33. A production subsidy plus a consumption tax.
34. A subsidy to both consumption and production.
35. A subsidy to both consumption and production.
36. An import tariff can be interpreted as
37. A tax on both production and consumption.
38. A production subsidy plus a consumption tax.
39. A subsidy to both consumption and production.
40. A subsidy to both consumption and production.
41. An export tax may raise national welfare
42. never
43. always
44. if the country is a ‘small’ country in the world market
45. if the country is a ‘large’ country in the world market