

International Economics Field Exam Spring 2001

Instructions: Answer 5 of the following 6 questions clearly and legibly. Unclear answers will be considered incorrect.

1. Briefly define and discuss the following variables or concepts within the context of international finance (one to three paragraphs):

- a. Marshall-Lerner condition
- b. The monetary approach to exchange rate determination
- c. Feistein-Horiaka Puzzle
- d. Current Account Sustainability
- e. Balassa-Samuelson Effect

2. What model or economic intuition can explain the following economic events? (You may assume a different model for each.)

- a. an increase in the budget deficit leads to a depreciation of the domestic currency.
- b. you observe the domestic currency is appreciating despite the fact that the price level is increasing.
- c. The discovery of uranium reserves leads to a deterioration of the trade balance and an appreciation of the domestic currency.

3. Analyze what would happen to trade balance, domestic interest rates, the real exchange rate and the level of output of Verdenia (a small open economy with a high degree of capital mobility) in response to the following events:

- a. Scientists discover that Verdenia's oil reserves were much smaller than previously thought.
- b. The government of Verdenia, in their effort to control domestic inflation and stimulate growth, imposes severe trade restrictions as well as strict capital controls. Do you think these policies will be effective? Why or why not?

4. Many commentators argue that a prerequisite for economic growth is to liberalize trade restrictions and have capital flows move freely across countries. Do you agree with this? Explain.

5. What do you think caused the debt crisis of the 1980s? Explain. Do you think another debt crisis episode is likely to occur in the next few years? Why?

6. Which model do you think best explains the behavior of exchange rates over time? Explain. If you think that none of them do a satisfactory job, does it necessarily follow that exchange rates move randomly over time? Explain.