**EXAM II**

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Part A: MC Questions \_\_\_\_\_\_\_\_\_/75

Part B: SA Question \_\_\_\_\_\_\_\_\_/90

**Total**  \_\_\_\_\_\_\_\_\_/165

**Part A: Multiple Choice Questions**

(25 questions, each of which is worth 3 points)

**Instructions:** Choose the *best* answer. Mark your answer clearly on your scantron forms.

1. The graphs below show demand for labor in two countries, A and B, and several vertical labor supply curves. Use these diagrams to answer the question about the effects of migration from one country to the other in search of a higher wage. Let the amount of migration (change in labor supply) be equal to the (identical) horizontal distance between the supply curves in both graphs.

Country B

wB

wA

LA

DA

DB

a

b

c

d

e

h

g

f

SB

SB

SA

SA

LB

What is the effect of this migration on the **welfare of factors other than labor** in Country B?

1. They lose area (d+e).
2. They gain area (d+e)
3. They gain area d
4. They gain area (d+e+f)
5. Which of the following reasons for people migrating from one country to another is the most important in today’s world?
6. To escape persecution
7. For a better climate
8. Higher wages
9. For religious freedom
10. The Escape Clause permits the United States to
11. Limit imports in an industry if they are causing injury to domestic interests.
12. Resign from the World Trade Organization.
13. Limit imports in an industry if those imports are being priced unfairly.
14. Shift its trade in a good to a different trading partner.
15. Foreign direct investment was not large during the 1950s and 1960s. Why?
16. The World Bank discouraged FDI as being detrimental to economic growth.
17. Many countries did not trust foreign corporations, viewing them as agents of colonialism and imperialism.
18. The IMF required that FDI be restricted in order to facilitate the regime of pegged exchange rates.
19. Levels of investment generally were small, so that there was little available for FDI.
20. If a tariff levied by a small country causes the welfare of the country to fall, why would such a country ever use a tariff?
21. Because the producers who gain from the tariff are much more numerous than the consumers

who lose.

1. Because it always improves the country’s terms of trade.
2. Because the many consumers who lose from the tariff each lose so little that they do not bother to object.
3. Because the revenue from the tariff is larger than the dead weight loss from the tariff.
4. Suppose a German manufacturer of household appliances wants to take advantage of the cheaper labor available in the Czech Republic. Which of the following is not foreign direct investment?
5. License a Czech firm to produce its products under its own label.
6. Build a manufacturing subsidiary there and employ Czech workers.
7. Build a plant in the Czech Republic and send all German workers to operate it.
8. Buy a Czech firm that produces similar products, and adapt it to produce its own products.
9. Which of the following countries and groups of countries is **not** a significant host of FDI?

a**.**  Europe

b. United States

c. China

## d. Japan

1. The original name of the World Bank was
2. International Bank for Reconstruction and Development
3. International Trade Organization
4. International Monetary Fund
5. Bretton Woods Institute
6. Comparing multinational firms to local firms in the same industry, studies show that in general
7. MNCs pay higher wages than local firms.
8. MNCs make less extensive use of machinery than do local firms.
9. The products of MNCs are less likely to be protected by import tariffs.
10. MNCs do not buy raw materials from the local economy
11. Anti-dumping duty is
12. A tax on exports from abroad equal to the difference between their price in their home market and their price for export.
13. Tariff on imports that are in excess supply in foreign markets.
14. The international agreement not to dispose of waste products in international waters.
15. A requirement imposed by the International Monetary Fund on countries requesting assistance, designed to prevent them from undermining IMF objectives.
16. Which of the following would be an example of foreign direct investment from the United States to

Taiwan?

1. US bank buys bonds issued by a Taiwan computer manufacturer.
2. Warren Buffet (a US citizen) buys a controlling share in a Taiwanese electronics firm.
3. A US car manufacturer enters into a contract with a Taiwan firm for the latter to make and sell it

spark plugs.

1. The state of California rents space in Taipei for one of its employees to use promoting tourism in

California.

1. What is the connection, if any, between comparative advantage (CA) and foreign direct investment (FDI)?
2. Nothing. CA has nothing to do with FDI.
3. When a country’s firms invest abroad, this helps to create CA in the same industry at home.
4. When a country’s firms invest abroad, this helps to create CA in the same industry in the country where they undertake the investment.
5. Countries often engage in FDI in industries where the country they invest in has a comparative advantage.
6. The following include several reasons that government might give for using a tariff on imports. Which reason is **not** valid, in the sense that the effect described will not happen?
7. To help consumers.
8. To raise government revenue.
9. To raise incomes of producers.
10. To increase national welfare at the expense of foreigners.
11. The Smoot-Hawley Tariff Act
12. Created NAFTA.
13. Raised US tariffs on hundreds of products at the start of the 1930s.
14. Changed US tariffs to be in compliance with the GATT.
15. Raised tariffs on tulips imported into the Netherlands to over 100%.
16. If a country pegs its exchange rate at a level that is, and continues to be, overvalued, then it will eventually be the case that
17. Its exports will expand as foreign markets recognize the high value.
18. It will run out of foreign reserves.
19. People will engage in smuggling to avoid the official exchange rate.
20. Prices in the country will rise.
21. If a country’s currency is undervalued, and if its central bank is pegging its exchange rate but **not** sterilizing the effects of its intervention, then which of the following will happen?
22. Its central bank will sell its own currency on the foreign exchange market.
23. Its central bank will gain reserves of foreign currency.
24. The country’s money supply will expand.
25. All of the above.
26. If Canada were pegging the Canadian dollar to the U.S. dollar and also trying to sterilize the effects of its exchange market intervention, then when it buys U.S. dollars on the foreign exchange market, it should
27. Sell Canadian government bonds.
28. Buy Canadian government bonds..
29. Sell U.S. government bonds.
30. Buy U.S. government bonds.
31. Sterilization of exchange-market transactions by a central bank means to prevent those transactions from affecting
32. The level of its reserves
33. The level of the domestic money supply
34. The level of the foreign money supply
35. The spot exchange rate
36. Under a crawling peg
37. The exchange rate moves, but by amounts too little to notice.
38. The exchange rate is permitted to change only slowly within the band.
39. The par value of the currency is kept secret and changed slowly over time.
40. The central value of a pegged exchange rate is changed frequently, by small amounts, and with advance notice.
41. The infant industry argument says that

a. free trade creates the greatest benefit to an industry when it is newly established.

b. a country with a high rate of population growth, because of its high proportion of children, will have a natural comparative advantage in producing toys

c. when a country’s producers of a product are just starting, tariff protection may offset the disadvantage of high costs and allow them to learn to be more efficient over time.

d. developing countries tend to specialize in production of primary products, the prices of which tend to fall over time.

1. Based on the Big Mac Index and because of the fact that burgers are not traded internationally, “emerging economies” tend to have

a. Over-valued exchange rates because their wages are low.

b. Over-valued exchange rates because their wages are high.

c. Under-valued exchange rates because their wages are low.

d. Under-valued exchange rates because their wages are high.

1. The price at which one can enter into a contract today to buy or sell a currency 30 days from now is called a

a. Reciprocal exchange rate.

b. Effective exchange rate.

c. Exchange rate option.

d. Forward exchange rate.

1. An advantage of a pegged exchange rate in comparison to a flexible exchange rate is that

a. The pegged rate permits the country to use inflation to reduce the value of a government debt.

b. By keeping the exchange rate unchanged, prices of different goods and services are forced to move together, avoiding disruptive changes in relative prices.

c. It provides investors with confidence that markets are being allowed to do their work.

d. If the peg is able to be sustained over time, it avoids costly movements up and down in exchange rates.

1. An increase in the U.S. demand for the Mexican peso
2. causes the U.S. dollar to depreciate.
3. causes Mexican goods to be relatively more expensive.
4. causes an increase in the U.S. dollar price of a Mexican peso.
5. All of the above.

**Part B: Short Answer Questions**

Points for each part are in parentheses.

**Instructions:** Write your answers on this exam sheet.

1. (18) Suppose that Mexico has previously had restrictions on inflows of foreign direct investment from all sources, including the United States. Then suppose that they remove those restrictions on flows from the United States in a particular industry, say hammocks. As a result, several hammock producers in the US move production to Mexico via FDI. Indicate for each of the groups below whether you expect them to gain or to lose from this flow of investment. If you think it could go either way please write a *one sentence justification for your answer*!

1. Workers previously employed in hammock production in the US.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Unchanged | (check one) |

1. Workers previously employed in hammock production in Mexico.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Unchanged | (check one) |

1. Owners of firms that move production to Mexico.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Unchanged | (check one) |

1. Owners of US hammock firms that do not move production to Mexico.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Unchanged | (check one) |

1. Owners of firms in Mexico that previously produced hammocks.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Unchanged | (check one) |

1. US consumers of hammocks (assume that there already was free trade in hammocks).

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Unchanged | (check one) |

1. (10) Which of the following is FDI?

|  |  |  |
| --- | --- | --- |
|  | i: | Procter and Gamble deposits money in its bank account in Japan. |
|  | ii: | Microsoft builds a plant in Brazil and sends all American workers to operate it. |
|  | iii: | A US investor buys 60% of the stocks of BMW AG, the German automobile company. |
|  | iv: | General Electric buys an Indian firm that produces refrigerators, and adapts it to produce its own products. |
|  | v: | Mattel contracts a Mexican firm to do some of the Barbie processing. |
|  | vi: | Intel builds a plant in Malaysia and hires young Malaysians to work in producing microprocessors. |
|  | vii: | A rich American lends money to a rich Brazilian, to be used in expanding the Brazilian’s business. |

1. (12) Fill in the blanks in the following:

The two fundamental principles of the WTO, are (1) the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_Principle and (2) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Under principle (1), a country must extend the same \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_to each \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ as it would to its \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_nation, thereby eliminating discrimination between trading partners within the WTO. Principle (2), on the other hand, eliminates discrimination between domestic and foreign \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, once they enter the domestic market.

1. (16) The world’s largest exporter of cotton is the United States, whose cotton farmers are given $4 billion a year in production subsidies. The world’s largest producer of cotton is China, but because it uses even more cotton than it produces, it is also the world’s largest importer of cotton. However, there are other countries that depend even more on cotton trade than these two, since the US and China both export and import lots of other things as well. For example, in five countries of Africa – Benin, Burkina Faso, Chad, Mali and Togo – cotton makes up more than 50% of their exports, and contributes a significant share to their (small) GDPs. In contrast, other poor countries such as Bangladesh, depend heavily on cotton imports to supply inputs to their manufacture of clothing.

From the facts in the preceding paragraph, indicate which of the groups below gain, and which lose, from the US cotton subsidies:

1. Cotton farmers in the United States

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. Cotton farmers in China

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. Cotton farmers in Burkina Faso

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. Garment manufacturers in Bangladesh

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. Garment manufacturers in Mali

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. The country of China as a whole

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. The country of Benin as a whole

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. The country of the United States as a whole

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Gain |  | Lose |  | Can’t tell | (check one) |

1. (16) True-False. **Circle the correct answer.**

You will earn a **bonus point** for false statements that you correct to make true. Cross out the incorrect word(s) and write the correct one(s) next to it (them), or rewrite the complete sentence to make it correct. You may earn a maximum of four bonus points for correcting the false statements below (which may be more or less than four!) and only your first 4 corrections will be counted.

1. Small countries stand to gain less from participation in the WTO process than if they were left out completely.

True False

1. Capital inflows that take the form of direct investment may be particularly beneficial if they bring new technologies, new management techniques, and new ideas to the host country.

True False

1. Trade barriers are an expensive and grossly inefficient way to reach most of the goals for which they are used.

True False

1. In “The Choice” Dave argues that tariffs are equivalent to quotas.

True False

1. FDI by US firms overseas can only destroy American jobs.

True False

1. A foreign company might be accused of “dumping” its products in the US market if its own home market is heavily protected.

True False

1. One of the main criticisms of the IMF today is that it lends too much money to economies in trouble without enough emphasis on economic reforms.

True False

h. A depreciation of the U.S. dollar leads to a higher volume of U.S. exports.

True False

6. In each of the cases below, diagrams show the foreign exchange market for a particular country vis a vis the US dollar. The country’s currency is either floating or pegged, as indicated, and if it is pegged, the central bank of the country is either sterilizing or not sterilizing, as also indicated.

1. (4)Germany’s central bank, the Bundesbank, is pegging its currency the deutsche mark, DM, to the US dollar, and it is *not* sterilizing. (4 points)i. In the initial situation,

|  |  |  |
| --- | --- | --- |
| Germany’s reserves are |  | expanding, |
|  |  | contracting, |
|  |  | holding constant, |
|  | | |
| and its money supply is |  | expanding. |
|  |  | contracting. |
|  |  | holding constant. |

ii. Now, the demand for exports of German cars expands. (**Show this in the diagram.)**

1. As a result, the Bundesbank will

|  |  |  |
| --- | --- | --- |
| increase |  |  |
| decrease |  | the pace at which it intervenes. |
| not change |  |  |

1. (4) The United States central bank, the Fed, is pegging the US dollar to the British

pound (£), and it *is* sterilizing. (4 points)



1. In the initial situation,

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | buying |  |
| The Fed is |  | selling | British pounds |
|  |  | neither buying nor selling |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | buying |  |
| and |  | selling | bonds |
|  |  | neither buying nor selling |  |

1. Now, interest rates in the United Kingdom go down. As a result of this change

|  |  |  |
| --- | --- | --- |
| US’s exchange rate will |  | appreciate, |
|  |  | depreciate, |
|  |  | remain unchanged, |
|  | | |
| and its reserves will |  | rise more rapidly. |
|  |  | rise less rapidly. |
|  |  | fall more rapidly. |
|  |  | fall less rapidly. |
|  |  | continue to change as before. |
|  |  | continue to remain constant. |

1. (4)The Mexican central bank, Banco de México, is pegging the peso (here denoted “MX$”) to the U.S. dollar ($), and it is *not* sterilizing. (4 points)



1. In the initial situation,

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | buying |  |
| The Banco de Mexico is |  | selling | Mexican pesos |
|  |  | neither buying nor selling |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | buying |  |
| and |  | selling | bonds |
|  |  | neither buying nor selling |  |

1. Now, Mexico devalues the peso. As a result Banco de Mexico will

|  |  |  |
| --- | --- | --- |
| increase |  |  |
| decrease |  | the pace at which it buys/sells dollars |
| not change |  |  |
|  |  |  |
| and the Mexican money supply will |  | rise more rapidly. |
|  |  | rise less rapidly. |
|  |  | fall more rapidly. |
|  |  | fall less rapidly. |
|  |  | continue to change as before. |
|  |  | continue to remain constant. |



7.(6)