

## Final Exam

International Economics  
Monterey Institute of International Studies  
Fall Semester 2002  
Dr. Robert M. McNab

Instructions: You may use any material you believe necessary to answer each question, to include lecture notes, the recommended readings, or other materials. You may not collaborate in any way with another student in this class. The instructor reserves the right to give any student an oral exam in lieu of this written exam if collaboration is suspected. Contact the instructor immediately with any questions about the content, structure, or process of this examination.

Time: The deadline for this exam is Wednesday, December 11, 2002 at 4 pm. You may email your answers before the deadline or present your completed exam in person. The instructor will not accept exams that are turned in late. It is the student's responsibility to ensure that the instructor has received the completed examination before the deadline.

Structure: Read each question carefully. In some cases, a question may be dependent upon your answer to a previous question. Answer each question to the best of your ability. Each answer will be graded completely, that is, if you include supplemental information in your answer that is not correct, the supplemental information will also be graded. Complete, concise answers have historically received higher grades than complete, rambling answers. Finally, the student should completely edit their exam to ensure that no significant style, grammar, or content errors remain before submitting the exam for grading.

### 1. Debt Instruments and Financial Markets (25 Points)

- a. Discuss, in your own words, the relationship between the price and yield of a bond. Provide a numerical example to support your discussion of the relationship between the price and yield of a bond. Discuss and provide a numerical example of the concept of "risk premium."
- b. Discuss, in your own words, the differences between forward and futures currency contracts. Discuss the difference between long and short selling and call and put options. Discuss, in your own words, why these concepts are important for understanding the operation of international currency markets.
- c. Discuss, in your own words, the concepts of asymmetric information and moral hazard. What evidence is there to support the argument that the International Monetary Fund induces moral hazard in international financial markets? If moral hazard exists, what are the implications for

borrowing by developing countries, that is, what happens to the risk premium and thus debt service loads over time?

2. Discussing marginal returns in production and marginal utility in consumption and implications for trade theory (25 points)
  - a. Discuss the linkages between factor endowments, the relative price of each factor endowment and how it relates to the marginal productivity of each factor, and the specialization of a country in a specific good or goods.
  - b. Using (a) as the foundation for your discussion, discuss and provide examples of how you would explain these concepts to a non-economist policymaker.
  - c. Discuss how factor endowments may influence the balance of payments and exchange rates over time. In writing your response, assume that you are preparing to discuss this with individuals who have a background in economics, so you should do sufficient research to provide statistical information to ground your discussion. What are the policy implications, in your opinion, for those countries that have specialized, over time, in one or two primary commodity products?
  
3. Balance of Payments, Trade Theory, and Financial Markets (25 Points)
  - a. What is meant by a current account deficit? What is meant by a capital account deficit? Can a country have a simultaneous deficit in the current and capital accounts?
  - b. Using the readings and discussion on Argentina, briefly discuss why the Argentinean Peso was pegged to the United States Dollar. Using trade theory and the discussions related to international financial markets, discuss why sustaining the peg was not a viable policy option. Make sure to examine the evolution of the Argentinean terms of trade under the peg and without the peg, the impact of the peg on the balance of payments, and provide statistic information to ground your arguments.
  - c. Using the current situation in Argentina as a foundation for your discussion, what would you recommend to the Argentinean government as a prudent course of action? Assume that you are presenting your argument to a reader who is well informed about the situation in Argentina and thus you will need to carefully construct your argument and provide sufficient information to ground your argument in the state of the Argentinean and surrounding economies.

#### 4. Construct Policy Question and Answer (25 Points)

For this question, you are tasked to develop one specific policy question that would be given to a similar class on a final exam.

The question should be of sufficient breadth that the student will have to review their readings and provide statistical information to support their answer. The question, however, should be sufficiently limited that the student will be able to answer it in less than 4 pages (single space) and in a reasonable period of time.

You have examples of previous policy questions from this course and the previous course in International Economics. While you may refer to these questions for guidance, these specific questions may not be used (or modified slightly) for the purpose of this assignment.

Your policy questions should consist of: (1) an introduction that places the student in context, that is, why are they writing this question and what is the application of the answer that the student provides; (2) specific instructions on the content and breadth of the response to be provided by the student; (3) a specific policy question that is to be answered by the student; and (4) requests, if necessary, for reference material, to include articles and statistical information.

Once you have constructed your policy question, you are to write the response to the question that you would expect the student to write, that is, the answer key. You are to follow your guidelines as specified in the setup of the policy question.

We will discuss this part of the exam in class to ensure that there is no ambiguity about this part of the exam. If you also require additional assistance, email or phone the instructor immediately.