

Write your name on the cover of the test booklet and nowhere else. (So that I do not know who wrote the answers.) Enclose this sheet and any graph paper you used with the booklet. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I can give extra time, but I will not give much.

1) (8 points each) For TWO of the events below, set up the double entry bookkeeping. Briefly explain how you determined the debits and the credits.

- A) I pay for a hotel in London for \$500.
- B) A citizen of the USA sends \$500 worth of clothes to Haiti for earthquake relief.
- C) A Japanese company buys \$600 worth of stock in Ford.
- D) An American buys \$300 worth of computer supplies from South Korea.

2) (12 points each) Find TWO of the following account balances using the table to the right. Briefly explain how you found them.

- A) Current Account
- B) Capital Financial Account
- C) Short-term Financial Account

Account	Credit (+)	Debit (-)
Exports of goods	\$300.00	
Exports of services	\$100.00	
Income from abroad	\$50.00	
Imports of goods		\$400.00
Imports of services		\$150.00
Income paid to foreigners		\$30.00
Capital account, net		\$5.00
Exports of stocks and bonds	\$330.00	
Imports of stocks and bonds		\$220.00
Bank liabilities to foreigners		\$15.00
US owned accounts abroad	\$22.00	
Statistical discrepancy	\$18.00	

3) (12 points) Answer EITHER Part A OR Part B.

A) Without drawing a graph, what would be the effects at home and abroad of us imposing an export quota which is not auctioned off? What happens to the prices in both countries, quantity sold in both countries, and our producer's profits? Assume we are a small country.

B) We said the quotas can have the same effects (on prices and quantity sold) as tariffs. Explain the economic reason why they have the same effect.

4) (14 points) Answer EITHER Part A OR Part B.

A) What is meant by *persistent dumping*? Why would a firm do that? Is that good or bad for the country which is dumped on? Explain your logic.

B) Explain the *scientific tariff* argument for restricting trade. In addition to the problem of retaliation by our trading partners, what is a problem with the argument?

5) (12 points) Answer EITHER Part A OR Part B.

- A) What is absolute PPP? Why would you expect it to hold?
- B) What is absolute PPP? Why would you expect it to not hold?

6) (14 points) Answer EITHER Part A OR Part B.

- A) Would you consider the EU to be a free trade area, customs union, common market, or economic union? Explain why you chose that rather than the others.
- B) When forming a customs union, is the customs union more likely to lead to increased welfare (trade creation greater than trade diversion) or decreased welfare if the countries are economically large? Explain your logic.

7) (14 points) Answer EITHER Part A OR Part B.

- A) Draw the CIAP diagram. Explain why the center line looks as drawn and explain what would happen if the economic situation was well below the line. Why would that occur?
- B) Explain what a *foreign exchange option* is. How can it be used to reduced foreign exchange risk if you knew you would be getting £1000 in three months?

8) (16 points) For EITHER the event in Part A OR the event in Part B, illustrate the effects of that event on the S/D for the ¥, with the \$ as the other currency. Explain why the curve(s) moved as drawn. Which currency appreciated? How can you tell?

- A) The Japanese economy picks up.
- B) Prices in the USA go up.

9) (28 points) Answer EITHER Part A OR Part B.

- A) Draw the supply and demand for a good we import and we are a small country. Illustrate the effects of an import quota which is **not** auctioned off. Explain why the curve(s) moved as drawn. Find the consumer surplus and producer surplus with and without the quota. Briefly state how you found them. What areas are lost with the quota? Are any of those areas gained by somebody else? If yes, explain who earns it and why.
- B) Draw the supply and demand for a good we import and we are a small country and have a non-prohibitive import tariff on. Suppose we join a customs union. Draw the diagram such that $P_C + T > P_N + T > P_C > P_N$. Here “*c*” represents a country in the customs union and “*N*” represents a non-union country. Find the consumer surplus, producer surplus, and tariff revenue for both the pre-union situation and for the customs union. Briefly state how you found them. Given your diagram, is there more trade creation than trade diversion or vice versa? How do you know?