B01.2303 Global Business Environment

Sample Questions for the Proficiency Exam

*True False Questions. Write either TRUE or FALSE next to each statement*

1. Of the following, which are (in good part) included in Korea's GNP:
   (a) Korean-made IBM computers sold in China,
   (b) the salary of a Korean working for IBM in New York for a year,
   (c) the profits of the IBM plant in the Korea owned by American citizens,
   (d) the salaries of the American managers of the Korean IBM plant.

2. In periods of economic boom, we generally see:
   (a) low rates of growth of GDP,
   (b) a worsening of the current account balance,
   (c) a fall in tax revenues,
   (d) an increase in inflation if the economy is growing faster than potential

3. When the Dollar/Euro forward exchange rate \( f_{SE} \) is lower than the current spot Dollar/Euro rate \( s_{SE} \), i.e. when \( f_{SE} < s_{SE} \):
   (a) US interest rates are higher than European interest rates,
   (b) investors are expecting a depreciation of the Dollar relative to the Euro.
   (c) inflation in the US is lower than in Europe,
   (d) the dollar will usually appreciate relative to the euro.

4. Under fixed exchange rates, domestic interest rates will be above foreign ones:
   (a) if the peg is perfectly credible but the country is subject to default risk,
   (b) the fixed peg is not fully credible,
   (c) the peg is fully credible and there is no default risk but domestic inflation is higher than world inflation,
   (d) the peg is fully credible and foreign interest rates have fallen.

5. The following action is legal under WTO.
   (a) A US tariff of 20% against any country that exports more than twice as much to the US as it imports in return.
   (b) A US import tax on a collection of European goods aimed at retaliating EU’s restriction on US companies’ exporting of bananas grown in the Caribbean, which the WTO ruled, illegal.
   (c) Subsidies to the Canadian Atlantic provinces to raise its ability to compete.
   (d) A ban of US beef exports to the EU because US cattle farmers used some growth hormone.
   (d) Indonesia waives its import taxes on Korean car parts because they are purchased by a local car assembler owned by the government.
   (e) Salt fish can cause cancer. Hong Kong banned such imports (but some Hong Kong fishermen produce salt fish locally.) [This question is fictional.]
Brief essay or analytical questions

1. “In the simple Ricardian model, trade between similar economies is unlikely to generate large gains from trade.” Is the statement true or false? Briefly explain why.

2. Look at the figure below that depicts the effect of an import quota (only a certain quantity of goods can be imported in a year, the rest are supplied domestically) on the US bicycle market. (These effects are hypothetical – there is currently no import quota on bicycles).
   a. Of the two prices listed, 330 and 300, which is the world price?
   b. While the domestic supply ($S_d$) is a straight line, why is the supply curve resulting from introducing a quota ($S_d + Q_Q$) kinked twice?
   c. With imports, but without a quota, how many bicycles would US makers produce? And with the quota?

A. The U.S. market for bicycles

![Diagram showing the effect of an import quota on the US bicycle market.](image)
Still referring to the import quota diagram… using the \(a, b, c, d\) labels,

\(d\). What is the change in producer surplus from introducing a quota versus no quota?

\(e\). What is the change in consumer surplus?

\(f\). Who gets the grey shaded area “\(c\)”? (Hint: who benefits from the quota?).

\(g\). What are “\(b\)” and “\(d\)”?

\(h\). What is the net welfare outcome for the nation from summing up \(a, b, c\) and \(d\)?

3. The General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) both seek to promote trade, reduce tariffs, and adjudicate disputes. How is the GATT different from the WTO? List at least three ways.

4. Define the following terms: voluntary export restraints, anti-dumping duties, countervailing duties.

5. The assumption behind government involvement in strategic trade policies is that there are dynamic economies of scale (learning by doing). Briefly explain the concept and explain why the capital market will not capitalize the learning economy?

5. Consider the following string of transactions:
An Italian shoemaker purchases 1000\$ of local leather to produce 1000 pairs of shoes. She then sells the shoes to Prada (an Italian company) for 10000\$. Prada then rents a shop in Soho from an US realtor for 500.000\$ and there sells the shoes for 1000000\$. How do they affect GDP, GNP and Current Account of US and Italy.

6. Siliconia is a new independent country that produces mainly flat panel monitors. The relative price of these monitors has been declining rapidly through time. Suppose Siliconia measures real GDP in each year using base year prices with 1995 as the base year. Do you think that the resulting measure for real growth in 2002 will be?

\(a\) Understated
\(b\) Overstated
\(c\) Accurate

Why?

7. Define the concepts of Labor Productivity and Total Factor Productivity. Suppose that the US is going to experience a 10% growth in aggregate investment and a 5% growth in aggregate total factor productivity. Is labor productivity likely to grow more or less than 5%? Explain.
8. Suppose that in January 2003 1 dollar is worth 5 Mexican pesos and for year 2003 Mexico has an expected inflation of 10% while US has an expected inflation of 2%. On the basis on this information alone what would you expect the value of the peso relative to the dollar to be one year from now?

9. From 1991 to 2001 Argentina was on a monetary regime called "Currency board". Define what a currency board is and explain why it is often effective in preventing high inflation. What is the difference between a currency board regime and a dollarization regime?

10. What is a leading macroeconomic variable? what is a countercyclical variable? can you give an example of a variable that is leading and countercyclical.

11. Assume that Country A and country B both have the aggregate production function  
\[ Y = F(K,L) = K^{1/2} L^{1/2} \] 
where Y is GDP, K is the aggregate capital stock and L is the number of workers in the country 

a. Suppose to start with that the two countries have identical savings rates and depreciation rates. Suppose country B has twice as large a population as country A. Which country will have larger steady state GDP per capita, and why?

b. What is the per-worker production function, \( y = f(k) \)? where \( y \) is GDP per worker and \( k \) is capital stock per worker.

c. Assume that neither country experiences population growth or technological progress and that 5 percent of capital depreciates each year. Assume further that country A saves 10 percent of output each year and country B saves 20 percent of output each year. Find the steady-state level of capital per worker for each country. Then find the steady-state levels of income per worker and consumption per worker.

12. Suppose Greenspan wants to keep the housing market strong, and would therefore like to push down long term interest rates (which determine the interest rate for 30 year fixed rate mortgages). What policy should he pursue to achieve his goal, and what will be the effect of this policy on short term interest rates? (In your answer you might want to use a quantity equation in growth rates and the Fisher relation between nominal interest rates, real interest rates and inflation)