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Name:.....

Econ 364
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Exam 3

(I) Intertemporal Trade

Consider the model of intertemporal trade developed in class. Assume there are two countries (call them "Home" and "Foreign") with nice PPF frontiers between present and future consumption good (corn). Home has a comparative advantage in the production of time 0 corn and Foreign has a comparative advantage in the production of time 1 corn. Countries have nice and identical preferences and are trading freely intertemporally. If a country borrows at time 0 from the other it will do so by issuing an IOU in exchange for the corn. If instead a country lends time 0 corn to the other, it will receive in exchange an IOU issued by the other country. Assume that the free trade interest rate is identified as r^* and use the vertical axis for time 1 good and the horizontal axis for time 0 good.

- (1) **(8 pts)** Draw a diagram that shows Home's production and consumption points under free trade with Foreign. Identify the country's investment, exports and imports in both periods.
- (2) **(4 pts)** What are the signs of Home's current and financial accounts in each period?

Suppose that suddenly a new country identical to Foreign and called CloneForeign starts trading intertemporally with the initial two. As a result the world interest rate **increases**. Answer questions (3) and (4).

- (3) **(8 pts)** What will happen to Home's production and consumption in periods 0 and 1 as a result of the change in the interest rate? Justify clearly using an explanation and a diagram.
- (4) **(6 pts)** Do you think that Foreign will be better off or worse off than in the initial situation when there were only two countries? Justify clearly using explanations and a diagram.

(II) Short/Medium questions

- (1) **(4 pts)** Briefly explain what is the “Nondiscrimination” principle in the GATT/WTO .
- (2) Briefly answer the following questions about Preferential Trade Agreements (PTA’s):
 - (a) **(3 pts)** do they violate a WTO/GATT principle? Justify
 - (b) **(3 pts)** what are “rules of origin” and when are they necessary?
 - (c) **(6 pts)** why are PTA’s associated with the concept of “trade diversion”?
- (3) **(8 pts)** Briefly identify two US trade laws that allow a tariff to be imposed on “unfairly traded imports”? Under which circumstances can they be used?
- (4) **(5 pts)** Briefly identify the US trade law that can result in protection against “fairly traded imports”. Under which circumstances can this law be used?
- (5) For each of the following transactions indicate on which account the credit occurs and on which account the debit occurs in the US balance of Payments (you need to clearly justify why when dealing with the FA) Use the attached BOP for guidance with the accounts.
Here is the list of transactions you need to identify:
 - (a) **(4 pts)** A US agent imports wine from Italy. He pays with a check in Euros drawn from his account in France.
 - (b) **(4 pts)** A US resident does a consulting job for a Swiss firm. She gets paid in dollars.
 - (c) **(4 pts)** A Japanese bank buys US Treasury Bonds from a US bank. It pays in Yen.
- (6) According to Prof. Chinn’s presentation:
 - (a) **(4 pts)** How does Trade act as transmission mechanism of the global financial crisis?
 - (b) **(4 pts)** Why will a commodity exporter like Argentina will most likely be in “trouble” soon?