MASTER OF ARTS EXAMINATION, 2018
(2ND YEAR, 4TH SEMESTER) (OLD)

ECONOMICS
PAPER: INTERNATIONAL ECONOMICS II

Time: Two Hours | Full Marks: 30

Answer two questions

1. Consider a small open economy producing non-traded public services along with exportables using imported intermediate inputs like oil apart from labour. The exportable is assumed to be labour intensive, while the non-traded service is capital intensive. In both industries, perfect competition prevails and production is subject to CRS with fixed input coefficients.
   (a) Construct the open economy model and solve for output, employment and relative price in terms of exogenous real wage.
   (b) Under what conditions output will unambiguously increase with an increase in real wage?
   (c) Will there be an unambiguous increase in employment with an increase in real wage? Justify.
   (d) If there is a hike global oil price, what are employment effects in the small open economy? 4+2+6+3

2. Consider a small open economy with fixed exchange rate at an initial underemployment equilibrium where trade is balanced.
   a) Show that an import tariff unambiguously creates a trade surplus while it has positive impact on output under certain conditions.
   b) Does an export subsidy have similar effects on output and trade balance? Justify your answer.
   c) There can be another commercial policy which will have unambiguous positive impact on output and trade balance? Explicate.
   d) Can this other commercial policy, as mentioned in (c), be an alternate to import tariff and export subsidy together? Justify. 4+4+4+3

3. a) Show how money market and foreign exchange market together determine exchange rate both under price stickiness in the short run and flexible prices in the long run.
   b) If questions are raised on the validity of the PPP principle in the long run and uncovered interest parity condition, and shift parameter is being introduced in the money demand function, how will the monetary model of exchange rate determination change?

[Turn over

c) With home and foreign assets being held in a portfolio, following Frankel, what does the integrated model of exchange rate determination show? If uniform asset demand preferences are introduced along with perfect substitutability, how does the integrated model of exchange rate determination change? 4+4+7

4. a) How is the BOP equilibrium arrived at using monetary approach to BOP? Does this approach contain the basic tenets of Hume's price-specie flow mechanism?

   b) Does an increase in money supply temporarily worsen the BOP whereas a nominal devaluation proportionately raises the domestic price and the money supply under non-sterilization assumption? How do the results change with the central bank introducing sterilization?

   c) Countries can use their external wealth as a buffer to smooth consumption in the face of fluctuations in output or investment. How will the current account intertemporally adjust in such an event? How different are these results from that of the monetary approach to BOP? 3+5+7