

AFRICAN ECONOMIC RESEARCH CONSORTIUM

**Collaborative MA Programme in Economics for Anglophone Africa
(Except Nigeria)**

JOINT FACILITY FOR ELECTIVES JUNE – OCTOBER 2006

INTERNATIONAL ECONOMICS II

Second Semester: Final Examination

Duration: 3 Hours

Date: Thursday, October 5, 2006

INSTRUCTIONS:

Answer **Question 1** and **Any Other 3 Questions**. *Note: Question 1 is COMPULSORY.*

Explore mathematical models with clearly identified variables and/or clearly labeled diagram(s) to support your discussion where appropriate.

Clearly highlight all simplifying and underlying assumptions. Your answers should be well structured and straight to the point.

1. Fully explain the link between the following:
 - (a) Multiple balance of payments equilibria and the *J*-curve effect **(5 marks)**
 - (b) Purchasing power parity and the real exchange rate **(5 marks)**
 - (c) Regressive expectations and the acceleration hypothesis **(5 marks)**

2. Discuss the covering alternatives for an agent who has to make a future payment and decides to cover against exchange risk. Do any of these alternatives exist for investors in developing countries? **(15 marks)**

3. Explain the limitations of the absorption and monetary approaches to the balance of payments. What improvement, if any, can be made to these models to make them more relevant for developing countries? **(15 marks)**

4. “The assumptions underlying the Dornbusch overshooting model are more relevant for developing countries than those underlying the Mundell-Fleming model.” Is this statement true or false? Do we observe overshooting in developing countries?
(15 marks)
5. Discuss the limitations of the policy prescriptions of the monetarist model for designing the exchange rate regime for a small open economy. What criteria should be used to choose the best model to guide foreign exchange policy for a developing economy?
(15 marks)
6. Discuss the competing definitions of capital flight and examine the major causes of capital flight from developing countries.
(15 marks)

END