



AFRICAN ECONOMIC RESEARCH CONSORTIUM

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JOINT FACILITY FOR ELECTIVES
JULY - OCTOBER, 1996

INTERNATIONAL ECONOMICS

Second Session: Final Examination

Friday October 4, 1996

TIME ALLOWED: 3 HOURS

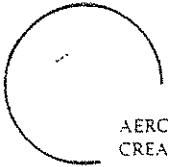
INSTRUCTIONS

Answer FOUR (4) question in all. You must answer ONE (1) question EACH from Sections A, B, C and D.

Your answers should be WELL-STRUCTURED and STRAIGHT TO THE POINT. Use appropriate graphic and/or mathematic representation where necessary.

SECTION A: Answer ONLY ONE (1) question from this section

1. Suppose a forward market in foreign exchange develops in your country and there are no exchange controls.
 - a) What types of transaction would you expect to observe in the market?
(3 points)
 - b) How would exchange rate expectations, the spot exchange rate, domestic and foreign interest rates interact to determine the equilibrium exchange rate in such a market?
(12 points)
2. a) Explain the absolute version of purchasing power parity. What are the weaknesses of this version of the theorem? How can the theorem be modified to circumvent these weaknesses?
(8 points)



6. If the balance of payments is a monetary phenomenon, what would be the effects of a negative monetary shock on the balance of payments, the exchange rate and the price level under
- a) a flexible exchange rate regime? (7 points)
 - b) a fixed exchange rate regime? (8 points)

SECTION D: Answer ONLY ONE (1) question from this section

7. a) Examine the relative effectiveness of fiscal policy in the Mundell-Fleming model of an open economy under flexible and fixed exchange rates when the aggregate supply function is relatively inelastic. (12 points)
- b) Why are the results in this case different from the basic Mundell-Fleming model? (3 points)
8. Critically examine the theoretical underpinning of the policy package typically recommended by the International Monetary Fund for correcting balance of payments disequilibrium in a typical African economy. (15 points)

QUESTION 5. International Capital Flows.

A large part of the turnover on foreign exchange markets are made up of international capital flows. What determine these flows, and are they signs of high international mobility?

- a) Discuss, (shortly), ways of estimating/measuring the degree of capital mobility. (3 marks)
- b) Discuss how to formulate a single equation for estimating capital flows, based on economic theory. (9 marks)
- c) Discuss the expected consequences on capital flows following a liberalization of the capital account. (3 marks)

QUESTION 6. Open Economy Macroeconomics

Suppose that there is a sudden unexpected increase in the net savings of the private sector in a small open economy, without exchange restrictions. What are the short-run consequences?

- a) Under fixed exchange rates? (4 marks)
- b) Under floating exchange rates? (4 marks)
- c) What are the most effective ways to dampen the effects on domestic income of the shock in case a and b? (4 marks)
- d) Discuss, the limitations of your analysis. (3 marks)