ICCE
INSTITUTE OF CERTIFIED CHARTERED ECONOMISTS

IE1

# INTERNATIONAL ECONOMICS I

PROFESSIONAL LEVEL

SYLLABUS & EXAMS GUIDE

# PROFESSIONAL LEVEL

## IE1 – INTERNATIONAL ECONOMICS I

SYLLABUS & EXAMS GUIDE

# OVERVIEW

The field of International Economics is traditionally divided into two parts. First, “International Trade,” the microeconomic part, attempts to answer questions arising from trade in goods and services. For example: how does trade arise among nations? Which nations will trade with each other, and which goods and services will they trade? How does trade impact different groups within a country, and how does government policy alter these impacts?

Second, “International Finance,” the macroeconomic part, attempts to answer questions arising from global financial markets and their impact on macroeconomic activity. For example, how are currency exchange rates determined? How do changes in exchange rates affect economic aggregates, such as a country’s trade deficit?

> You could say that the study of international trade and finance is where the discipline of economics as we know it began. Historians of economic thought often describe the essay “Of the Balance of Trade” by the Scottish philosopher David Hume as the first real exposition of an economic model.
>
> Hume published his essay in 1758, almost 20 years before his friend Adam Smith published The Wealth of Nations. And the debates over British trade policy in the early 19th century did much to convert economics from a discursive, informal field to the model-oriented subject it has been ever since.
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> Yet the study of international economics has never been as important as it is now.
>
> In the early 21st century, nations are more closely linked through trade in goods and services, flows of money, and investment in each other’s economies than ever before. And the global economy created by these linkages is a turbulent place: Both policy makers and business leaders in every country, including the United States, must now pay attention to what are sometimes rapidly changing economic fortunes halfway around the world.

A look at some basic trade statistics gives us a sense of the unprecedented importance of international economic relations. Figure 1-1 shows the levels of U.S. exports and imports as shares of gross domestic product from 1960 to 2009.

The most obvious feature of the figure is the long-term upward trend in both shares: International trade has roughly tripled in importance compared with the economy as a whole.

Almost as obvious is that, while both imports and exports have increased, imports have grown more, leading to a large excess of imports over exports.

This course introduces the main concepts and methods of international economics and illustrates them with applications drawn from the real world.

Over the past decade the global economy threw up many new challenges, from the backlash against globalization to an unprecedented series of financial crises. Economists were able to apply existing analyses to some of these challenges, but they were also forced to rethink some important concepts.

Furthermore, new approaches have emerged to old questions, such as the impacts of changes in monetary and fiscal policy.

*Source*: International Economics Theory & Policy, 9th Edition, by Paul R. Krugman, Maurice Obstfeld & Marc J. Melitz

# LEARNING OBJECTIVES

**This paper introduces candidates to the theory of International Economics and its application to the real world. Upon completion of this paper candidates should be able to:**

- Compare alternative theories of international trade
- Analyze and test international trade models
- Evaluate the impact of tariffs and non-tariff barriers
- Identify the validity and efficiency of protectionist policies
- Estimate the impact of preferential trade arrangements
- Explain models of Supply and Demand within the context of International Trade Theory Analysis
- Establishes the relationship between foreign trade theory and economic development.
- Explain liberalization of world trade, and international trade.
- Explain exchange markets, and exchange rate systems
- Analyze international monetary systems, and its importance
- Explain concepts of Foreign Payments Balance.
- Establishes the relationship between international economics and economic development.
- Relate relationship between Theory of Foreign Trade and Economic Development.

# RECOMMENDED TEXTS

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# READING TOPICS

## Introduction

- What Is International Economics About?
- International Economics: Trade and Money

## World Trade: An Overview

- Who Trades with Whom?
- The Changing Pattern of World Trade
- Do Old Rules Still Apply?

## Labor Productivity and Comparative Advantage: The Ricardian Model

- The Concept of Comparative Advantage
- A One-Factor Economy
- Trade in a One-Factor World
- Misconceptions About Comparative Advantage
- Comparative Advantage with Many Goods

## Specific Factors and Income Distribution

- The Specific Factors Model
- International Trade in the Specific Factors Model
- Income Distribution and the Gains from Trade
- The Political Economy of Trade: A Preliminary View

## Resources and Trade: The Heckscher-Ohlin Model

- A Model of a Two-Factor Economy
- Effects of International Trade Between Two-Factor Economies
- Empirical Evidence on the Heckscher-Ohlin Model

## The Standard Trade Model

- A Standard Model of a Trading Economy
- Tariffs and Export Subsidies: Simultaneous Shifts in RS and RD
- International Borrowing and Lending

## External Economies of Scale and the International Location of Production

- Economies of Scale and International Trade: An Overview
- Economies of Scale and Market Structure
- The Theory of External Economies
- External Economies and International Trade
- Interregional Trade and Economic Geography

## Firms in the Global Economy: Export Decisions, Outsourcing, and Multinational Enterprises

- The Theory of Imperfect Competition
- Monopolistic Competition and Trade
- Firm Responses to Trade: Winners, Losers, and Industry Performance
- Trade Costs and Export Decisions
- Dumping

## The Instruments of Trade Policy

- Basic Tariff Analysis
- Costs and Benefits of a Tariff
- Other Instruments of Trade Policy
- The Effects of Trade Policy: A Summary

## The Political Economy of Trade Policy

- The Case for Free Trade
- National Welfare Arguments Against Free Trade
- Income Distribution and Trade Policy
- International Negotiations and Trade Policy
- The Doha Disappointment

## Trade Policy in Developing Countries

- Import-Substituting Industrialization
- Results of Favoring Manufacturing: Problems of Import-Substituting Industrialization

- Trade Liberalization Since 1985
- Trade and Growth: Takeoff in Asia

## Controversies in Trade Policy

- Sophisticated Arguments for Activist Trade Policy
- Globalization and Low-Wage Labor
- Globalization and the Environment

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- You are not allowed to take to your exam desk, possess, use or intend to use while at that desk, any books, notes or other materials except those authorized by the exam supervisor. If you are found to have taken to your desk, or possessed while at that desk, unauthorized materials which are relevant to the syllabus being examined, it will be assumed that you intended to use them to gain an unfair advantage in the exam. In any subsequent disciplinary proceedings, it shall be for you to prove that you did not intend to use the materials to gain an unfair advantage in the exam.
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# EXAM RESULTS

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## NEWS PORTALS

- The Economy360
- FI Sense
- The Economist
- Bloomberg Business week
- Harvard Business Review
- Sloan Management Review

## JOURNALS

- The Economic Journal
- Quarterly Journal of Economics
- Journal of Financial Economics
- Journal of International Economics
- American Economic Review
- The Review of Economic Studies
- The Journal of Finance
- Journal of Political Economy
- Journal of Accounting and Economics
- The Review of Economics and Statistics
- The Review of Financial Studies
- Quantitative Economics
- Journal of Management Studies
- Journal of Econometrics
- Journal of Banking and Finance

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- ICCE Fees

# SAMPLE QUESTIONS

1. An important insight of international trade theory is that when two countries engage in voluntary trade
   A. one country always benefits at the expense of the other.
   B. it is almost always beneficial to both countries.
   C. it only benefits the low wage country.
   D. it only benefits the high wage country.

2. If there are large disparities in wage levels between countries, then
   A. trade is likely to be harmful to both countries.
   B. trade is likely to be harmful to the country with the high wages.
   C. trade is likely to be harmful to the country with the low wages.
   D. trade is likely to be harmful to neither country.

3. The benefits of international trade are derived from trade in
   A. tangible goods only.
   B. intangible goods only.
   C. goods but not services.
   D. anything of value.

4. Which of the following is NOT a major concern of international economic theory?
   A. protectionism
   B. the balance of payments
   C. exchange rate determination
   D. bilateral trade relations with China

5. "Trade is generally harmful if there are large disparities between countries in wages."
   A. This is generally true.
   B. This is generally false.
   C. Trade theory has nothing to say about this issue.
   D. This is true if the trade partner ignores child labor laws.

6. The United States is less dependent on trade than most other countries because
   A. the United States is a relatively large country with diverse resources.
   B. the United States is a "Superpower."
   C. the military power of the United States makes it less dependent on anything.
   D. the United States invests in many other countries.

7. The insight that patterns of trade are primarily determined by international differences in labor productivity was first proposed by:
    A. Adam Smith.
    B. David Hume.
    C. David Ricardo.
    D. Eli Heckscher.

8. The balance of payments has become a central issue for the United States because
    A. when the balance of payments is not balanced, society is unbalanced.
    B. the U.S. economy cannot grow when the balance of payments is in deficit.
    C. the U.S. has run huge trade deficits in every year since 1982.
    D. the U.S. never experienced a surplus in its balance of payments.

9. The study of exchange rate determination is a relatively new part of international economics, since
    A. for much of the past century, exchange rates were fixed by government action.
    B. the calculations required for this were not possible before modern computers became available.
    C. economic theory developed by David Hume demonstrated that real exchange rates remain fixed over time.
    D. dynamic overshooting asset pricing models are a recent theoretical development.

10. A fundamental problem in international economics is how to produce
    A. a perfect degree of monetary harmony.
    B. an acceptable degree of harmony among the international trade policies of different countries.
    C. a world government that can harmonize trade and monetary policies
    D. a counter-cyclical monetary policy so that all countries will not be adversely affected by a financial crisis in one country.

11. A country engaging in trade according to the principles of comparative advantage gains from trade because it
    A. is producing exports indirectly more efficiently than it could alternatively.
    B. is producing imports indirectly more efficiently than it could domestically.
    C. is producing exports using fewer labor units.
    D. is producing imports indirectly using fewer labor units.

| Unit Labor Requirements | | |
|---|---|---|
| | **Cloth** | **Widgets** |
| Home | 10 | 20 |
| Foreign | 60 | 30 |

12. Given the information in the table above, if it is ascertained that Foreign uses prison-slave labor to produce its exports, then home should
    A. export cloth.
    B. export widgets.
    C. export both and import nothing.
    D. export and import nothing.

13. As a result of trade between two countries which are of completely different economic sizes, specialization in the Ricardian 2X2 model tends to
    A. be incomplete in both countries.
    B. be complete in both countries.
    C. be complete in the small country but incomplete in the large country.
    D. be complete in the large country but incomplete in the small country.

14. Assume that labor is the only factor of production and that wages in the United States equal $20 per hour while wages in Japan are $10 per hour. Production costs would be lower in the United States as compared to Japan if
    A. U.S. labor productivity equaled 40 units per hour and Japan's 15 units per hour.
    B. U.S. labor productivity equaled 30 units per hour and Japan's 20 units per hour.
    C. U.S. labor productivity equaled 20 units per hour and Japan's 30 units per hour.
    D. U.S. labor productivity equaled 15 units per hour and Japan's 25 units per hour.

15. The Ricardian model of international trade demonstrates that trade can be mutually beneficial. Why, then, do governments restrict imports of some goods?
    A. Trade can have significant harmful effects on some segments of a country's economy.
    B. The Ricardian model is often incorrect in its prediction that trade can be mutually beneficial.
    C. Import restrictions are the result of trade wars between hostile countries.
    D. Imports are only restricted when foreign-made goods do not meet domestic standards of quality.

16. International trade can have important effects on the distribution of income because
    A. different industries employ different factors of production.
    B. of government corruption.
    C. the more powerful country dictates the terms of trade.
    D. rich countries take advantage of poor countries.

17. If a country produces good Y (measured on the vertical axis) and good X (measured on the horizontal axis), then the absolute value of the slope of its production possibility frontier is equal to
    A. the opportunity cost of good X.
    B. the price of good X divided by the price of good Y.
    C. the price of good Y divided by the price of good X.
    D. the opportunity cost of good Y.

18. The Heckscher-Ohlin model differs from the Ricardian model of Comparative Advantage in that the former
    A. has only two countries.
    B. has only two products.
    C. has two factors of production.
    D. has two production possibility frontiers (one for each country).

19. The assumption of diminishing returns in the Heckscher-Ohlin model means that, unlike in the Ricardian model, it is likely that
    A. countries will not be fully specialized in one product.
    B. countries will benefit from free international trade.
    C. countries will consume outside their production possibility frontier.
    D. comparative advantage will not determine the direction of trade.

***Assume that only two countries, A and B, exist.***

| Factor Endowments | Countries A | B |
|---|---|---|
| Labor Force | 45 | 20 |
| Capital Stock | 15 | 10 |

20. Refer to the table above. If good S is capital intensive, then following the Heckscher-Ohlin Theory
    A. country B will export good S.
    B. country A will export good S.
    C. both countries will export good S.
    D. trade will not occur between these two countries.

# ANSWERS

1. B
2. D
3. D
4. D
5. B
6. A
7. A
8. C
9. A
10. B
11. B
12. A
13. C
14. A
15. A
16. A
17. A
18. C
19. A
20. A

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IE2

# INTERNATIONAL ECONOMICS II

PROFESSIONAL LEVEL

SYLLABUS & EXAMS GUIDE

# PROFESSIONAL LEVEL

## IE2 – INTERNATIONAL ECONOMICS II

SYLLABUS & EXAMS GUIDE

# OVERVIEW

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# SAMPLE QUESTIONS

1. The exchange rate between currencies depends on
   A. the interest rate that can be earned on deposits of those currencies.
   B. the interest rate that can be earned on deposits of those currencies and the expected future exchange rate.
   C. the expected future exchange rate.
   D. national output.

2. Individuals base their demand for an asset on
   A. the expected return the asset offers compared with the returns offered by other assets.
   B. the riskiness of the asset's expected return.
   C. the asset's liquidity.
   D. the expected return, how risky that expected return is, and the asset's liquidity.

3. Which one of the following statements is the MOST accurate?
   A. A rise in the average value of transactions carried out by a household or a firm causes its demand for money to fall.
   B. A reduction in the average value of transactions carried out by a household or a firm causes its demand for money to rise.
   C. A rise in the average value of transactions carried out by a household or a firm causes its demand for money to rise.
   D. A rise in the average value of transactions carried out by a household or a firm causes its demand for real money to rise.

4. If individuals are holding more money than they desire
   A. they will attempt to reduce their liquidity by using money to purchase goods.
   B. they will attempt to reduce their liquidity by using money to purchase interest-bearing assets.
   C. they will attempt to reduce their liquidity by converting real money holdings into nominal money holdings.
   D. they will keep their holdings constant.

5. An economy's long-run equilibrium is
   A. the equilibrium that would occur if prices were perfectly flexible.
   B. the equilibrium that would occur if prices were perfectly flexible and always adjusted immediately.
   C. the equilibrium that would occur if prices were perfectly flexible and always adjusted immediately to preserve full employment.
   D. the equilibrium that would occur if prices were perfectly fixed to preserve full employment.

6. A permanent increase in a country's money supply
   A. causes a more than proportional increase in its price level.
   B. causes a less than proportional increase in its price level.
   C. causes a proportional increase in its price level.
   D. leaves its price level constant in long-run equilibrium.

7. A change in the level of the supply of money
   A. increases the long-run values of the interest rate and real output.
   B. decreases the long-run values of the interest rate and real output.
   C. has no effect on the long-run values of the interest rate, but may affect real output.
   D. has no effect on the long-run values of the interest rate and real output.

8. Central banks often intervene in currency markets. This activity is called
   A. managed floating.
   B. fixing exchange rates.
   C. currency warfare.
   D. super-pegging.

9. What is the expected dollar rate of return on dollar deposits if today's exchange rate is $1.10 per euro, next year's expected exchange rate is $1.165 per euro, the dollar interest rate is 10%, and the euro interest rate is 5%?
   A. 10%
   B. 11%
   C. -1%
   D. 0%

10. Fiscal expansion under fixed exchange rates will have what temporary effect?
   A. the money supply will decrease.
   B. output will decrease.
   C. the exchange rate will increase.
   D. the exchange rate will decrease.

11. Under fixed exchange rates, which one of the following statements is the MOST accurate?
   A. Devaluation causes a decrease in output, a decrease in official reserves, and a contraction of the money supply.
   B. Devaluation causes a rise in output, a rise in official reserves, and an expansion of the money supply.

C. Devaluation causes a rise in output and a rise in official reserves.
D. Devaluation causes a rise in output and an expansion of the money supply.

12. The main reason(s) why governments sometimes chose to devalue their currencies is (are)
    A. devaluation makes domestic goods more expensive in relation to foreign goods.
    B. devaluation makes domestic services more expensive in relation to foreign services.
    C. devaluation increases foreign reserves held by the central bank.
    D. devaluation improves the current account and increases foreign reserves held by the central bank.

13. A balance of payments crisis is best described as
    A. a sharp change in interest rates sparked by a change in expectations about the level of imports.
    B. a sharp change in foreign reserves sparked by a change in expectations about the future exchange rate.
    C. a sharp change in interest rates sparked by a change in expectations about the level of exports.
    D. a sharp change in foreign reserves sparked by a change in expectations about the level of imports.

14. The expectation of future devaluation causes a balance of payments crisis marked by
    A. a sharp rise in reserves and a fall in the home interest rate below the world interest rate.
    B. a sharp fall in reserves and an even bigger fall in the home interest rate below the world interest rate.
    C. a sharp fall in reserves and a rise in the home interest rate above the world interest rate.
    D. a sharp rise in reserves and an even greater rise in the home interest rate above the world interest.

15. The expectation of future revaluation causes a balance of payments crisis marked by
    A. a sharp rise in reserves and a fall in the home interest rate below the world interest rate.
    B. a sharp fall in reserves and an even bigger fall in the home interest rate below the world interest rate.
    C. a sharp fall in reserves and a rise in the home interest rate above the world interest rate.
    D. a sharp rise in reserves and an even greater rise in the home interest rate above the world interest.

16. Governments prefer to avoid excessive current account surpluses because
    A. the returns to domestic savings are more difficult to tax than those on assets abroad.
    B. an addition to the home capital stock may increase domestic unemployment and therefore lead to higher national income.
    C. foreign investment in one firm may have beneficial technological spillover effects on other foreign producers that the investing firm does not capture.
    D. an addition to the home capital stock may reduce domestic unemployment and therefore lead to higher national income.

17. Which of the following is one component of the "trilemma" that is faced by policy makers in choosing monetary arrangements?
    A. freedom of international capital movements
    B. exchange rate instability
    C. tariffs and subsidies
    D. restrictions on the migration of labor

18. Under the price-specie-flow mechanism, what happens when, say, Germany's current account surplus is greater than its non-reserve capital account deficits?
    A. German loans will finance all foreign net imports.
    B. Automatic drop in German domestic prices and rise in foreign prices.
    C. Gold reserves will flow into Germany.
    D. Gold reserves will flow out of Germany.

19. Imagine that there are two countries, Home and Far Far Away, and that residents of each own only one asset, domestic land yielding an annual harvest of mangoes. Assume that the yield on the land is uncertain. Half the time, Home's land yields a harvest of 5,000 tons of mangoes at the same time as Far Far Away's land yields a harvest of 2,500 tons. The other half of the time the outcomes are reversed. The average for each country mango harvest is
    A. 2500.
    B. 2750.
    C. 3500.
    D. 3750.

20. The international capital market is:

A. the international currency exchange.
B. a market in which capital assets are exchanged for services.
C. the market that is subject to intense regulation and must file a report to the Basel committee on a biannual basis.
D. not really a single market, but a group of closely interconnected markets in which asset exchanges with some international dimension take place.

# ANSWERS

| | |
|---|---|
| 1.B | 11. B |
| 2. D | 12. D |
| 3. D | 13. B |
| 4. B | 14. C |
| 5. C | 15. A |
| 6. C | 16. D |
| 7. D | 17. A |
| 8. A | 18. C |
| 9. A | 19. D |
| 10. D | 20. D |

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