

PRELIMINARY EXAMINATION FOR THE Ph.D. DEGREE

Instructions: Answer any 4 of the following 5 questions.

Question 1: Currency Crisis

The Asian financial crisis was marked by the following three features (a) a deep contraction in output, (b) a sharp devaluation of the domestic currency, and (c) a collapse of the domestic banking system.

It is often alleged that a panic first by international investors, and then sustained by domestic capital flight, were the causes of this constellation of outcomes.

- (a) (20 percent) The exchange rate depreciation did not cause an immediate large rise in exports. What mechanisms caused this non-standard response?
- (b) (20 percent) It was also alleged that a high interest rate would not reverse the capital flow. What mechanisms could have caused this non-standard response?
- (c) (60 percent) Show how you would modify a standard short-run IS-LM-BP model to produce these features in response to an investor panic. To make your model easier, you can appeal to (a) and (b) above if you wish.

Question 2: Fixed Exchange Rate Arrangements

- (a) (50 percent) Outline the alleged working of the Gold Standard System, and explain its deviations in practice.
- (b) (50 percent) Outline the working of the Bretton Woods System of Adjustable Peg, and explain its defects.

Question 3: Interest Rate Parity Conditions

- (a) Write an equation to represent each of the following, and interpret each briefly.
 - (1) Uncovered interest rate parity
 - (2) Covered interest rate parity

- (3) Real interest rate parity
- (4) Foreign exchange market efficiency condition

Be sure to define your variables. You may write the conditions as linear approximations, and you may assume risk neutrality.

- (b) Discuss the empirical literature testing the conditions above. Cite papers where you can.

Problem 4: Exchange Rates and Welfare

The New Open Economy Macroeconomics recently has addressed the issue of whether flexible or fixed exchange rates are better for improving welfare.

- (a) In 3-4 paragraphs, list the main papers in this literature, discuss what factors these papers say determine which regime is superior, and summarize the conclusions.
- (b) This literature stands in contrast to an earlier literature, including Mundell's notable theory on Optimal Currency Areas. In 2-3 paragraphs, summarize the factors that Mundell's said are important for deciding on an exchange rate regime, and contrast this with the conclusions from the more recent literature discussed above.

Problem 5: International Integration

Critique the following statement, heard often in the popular press: "We are living in an age of globalism, with an unprecedentedly high degree of international economic integration." Critique this statement in 5-7 paragraphs, summarizing the various types of empirical evidence on integration in goods and asset markets. Cite papers where you can.