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**Economics 233**

**Final Exam**

**Fall 2019**

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**Please answer all 3 questions in Part I . Then pick two of the essay questions in Part II. All work must be shown. Good Luck and Merry Christmas/Happy Holidays**

**Part I – Answer all questions:**

1. **Cadbury chocolate bars are produced in the UK and marketed in the U.S. They compete with chocolate bars made by Hershey’s and Mars. Suppose a Cadbury bar is £2 in UK and $2.50 in the U.S. Further, the exchange rate is currently $1.25/£. If the inflation rate is 0.9% in the U.S. and 1.8% in the UK:**
2. **What is the change in the exchange rate predicted by PPP?**
3. **Demonstrate that the chocolate bar costs the same at the end of one year if PPP holds.**
4. **Optima Controls has shipped $40 million in equipment to Europe under favorable repayment terms (180 days), and needs to borrow money to cover its receivables. It can borrow money in the U.S. at 2.2% for the period, or in the eurozone at 3.4%. There are currently $1.14 per euro. The exchange rate is expected to be $1.12/€ at the end of six months. Where should Optima borrow the money?**
5. **Acme Medical makes high-end medical equipment in both the U.S. and Europe, and is planning on opening a new construction facility in the Netherlands this year. The plant will cost €40 million, and will provide €10 million in additional returns in year 1, €20 million in year 2, and €20 million in year 3. At present, there are $1.10 per euro. The exchange rate is expected to rise to $1.12 one year out and $1.14 in years two and three. The U.S. discount rate is 5%, while in Europe it is 3%.**
   1. **Where should Acme borrow?**

**Part II: Answer two of the following four questions. Maximum of 2 bluebook pages each**

1. **The developing nation debt crisis of the 1980s was partly caused by rising interest rates in the industrialized world.**

**-State 3 other primary causes of the debt crisis**

**-Explain two policies that were initially used to try to address the crisis**

**-How were debt/equity swaps used later in the crisis**

**-What is conditionality? Explain how the IMF tried to manage the crisis, and why it was resented**

1. **What are the five payment methods typically used in international trade? Rate each according to the risk borne by both importer and exporter. Given your answer, why is the letter of credit the primary payment method?**
2. **Direct Foreign Investment is driven by multiple factors. State and explain four of those factors. One of the four must be GDP correlations.**