

**ECONOMICS 40223**  
**International Monetary Economics**  
Study Questions for Semester(Fall 2017)

**INSTRUCTIONS:** You will find below study questions designed to guide your studying. **A subset of these exact questions will appear on your exams.** You are under no obligation to complete them but there is, not surprisingly, a high correlation between doing these and earning a high grade! Please bear the following in mind:

*General issues*

- The exams are weighted such that a perfect score on all the questions from the list below earns you at least a low B. A's are reserved for those who also answer the "hell" questions correctly. That said, data from previous classes show that there is a high correlation between doing well on the non-hell portion of exams and scoring highly on the hell portions.
- I am also happy to check over your answers to make sure they are correct. Just send a copy to [j.harvey@tcu.edu](mailto:j.harvey@tcu.edu). Please see below for the dates by which I'll need to receive your answers.
- You are free to reword any lecture or reading question however you like. However, always be sure to send it to me on your study question list so that you can be sure that I agree it includes all the important information—don't wait until the exam to find out!
- If I check your study questions and accidentally approve an incorrect answer that you then give on an exam, you get full credit. If I initially subtract points, just let me know and I'll fix it. That's the John Harvey Guarantee!
- If you are resending questions to me, please let me know which ones are new and/or adjusted from last time so I don't have to check the entire list all over again.
- Studying involves taking this list and a blank piece of paper and writing out the answers until, according to your list of answers, you don't make any mistakes. **THERE IS SIMPLY NO SUBSTITUTE FOR DOING THIS!**

*Reading questions*

- The place where the study questions are the most helpful is on the readings (I write the lecture answers on the board). As a rule, I don't go over these in class and the study question list prevents you from having to guess which parts of "The Blessings of Free Trade" I expect you to remember for the exam. I tell you up front!
- Be sure to actually read the articles and not simply harvest them for the study question answers. If you do the latter, you won't really understand the context and you'll end up having to memorize. There's too much material to do that. Those who use someone else's study question answers face the same problem. I don't actually want you to just know what's on the list, I hope you learn much more than that. However, I'm only going to test you over the list.

### *Using someone else's answers*

- There is no rule against this. The study questions are not an assignment.
- If you and a friend (or enemy or bystander) worked on the questions together, please let me know when you send the questions to me so that I can be sure you both get the John Harvey Guarantee.
- If you did not work together but choose to use someone else's already-corrected study questions, please do not send them to me unedited. In other words, if I indicated on their answers that they needed to make adjustments, make these first. In addition, let me know which ones have been adjusted so I don't have to check the entire list all over again. If you already know they are perfect, please don't send them at all. Just email me saying, "I'm using Victor Boschini's study question answers!" and then you'll get the John Harvey Guarantee based on their answers. (FYI, he's never take this course so you should probably use someone else's. That was just an example.)
- If you choose to use someone else's study questions from a previous semester, all of the above apply plus one more: please see if the questions are the same as in the previous semester (I add and subtract whole questions and change the wording on others). If this hasn't been done, I'll return the questions unchecked. And I will wish terrible things on you and your family.

### *Study question organization*

- Questions are grouped by their source. For examples, questions based on lecture material have *Lecture* before them, and then appear without spaces between them. For questions where answers can be found in the reading, the specific link is given and the questions are then grouped without spaces.
- **Green questions may also appear on the final exam.**

### *Study question deadlines*

- Anyone wanting their exam one study questions checked must have submitted them to me by midnight, Thursday, September 14.
- Anyone wanting their exam two study questions checked must have submitted them to me by midnight, Tuesday, October 24.
- Anyone wanting their final exam study questions checked must have submitted them to me by midnight, Tuesday, December 5.
- Deadlines apply whether you take that exam at the regular time or not
- I do not recheck the green questions on the final exam list since they were subject to one of the two earlier deadlines.

## **BACKGROUND**

### *Lecture*

1. **Distinguish between validity and cogency. [25 words]**
2. List the balance of payments accounts. [29 words]
3. What is a floating or flexible exchange rate system. [13 words]

*The Basics of Foreign Trade and Exchange*

[http://personal.tcu.edu/jharvey/40223/Basics\\_of\\_FX.pdf](http://personal.tcu.edu/jharvey/40223/Basics_of_FX.pdf)

4. What may be necessary before you buy foreign goods or services, or to invest in other countries? [14 words]
5. What are the three main centers of trading, which handle the majority of all FX transactions? [3 countries]
6. According to the Federal Reserve Bank of New York, what are the four types of foreign exchange market participants? Please describe each in a sentence. [81 words]
7. What are the three reasons participants in the FX market trade? [35 words]

*Wikipedia: Foreign Exchange Market*

[http://en.wikipedia.org/wiki/Foreign\\_exchange\\_market#Financial\\_instruments](http://en.wikipedia.org/wiki/Foreign_exchange_market#Financial_instruments)

8. List and explain the five financial instruments available in the foreign exchange market (skip Non-deliverable forward (NDF)). [117 words]

*Wikipedia: Fixed Exchange Rate*

[http://en.wikipedia.org/wiki/Fixed\\_exchange\\_rate](http://en.wikipedia.org/wiki/Fixed_exchange_rate)

9. What is a fixed or pegged exchange rate? [35 words]
10. Generally speaking, what does maintaining a fixed exchange rate entail? What, for example, might a government have to do if a rate drifts too far below the desired rate? [56 words]

*Harvey: An Economic Framework for Studying Cyber Security Issues, under review at Military Cyber Affairs (you can probably skip to section 2)*

[http://personal.tcu.edu/jharvey/40223/Framework\\_for\\_Studying\\_Cyber\\_Security\\_Issues.pdf](http://personal.tcu.edu/jharvey/40223/Framework_for_Studying_Cyber_Security_Issues.pdf)

11. According to the discussion on pages 8 and 9, what is the primary determinant of employment? [1 word]
12. In a world with no government sector or trade, savings must be equal to investment. Which, however, is the driver? With respect to the one that simply follows, why is it largely a residual? [20 words]
13. What is, in reality, the only way to truly save more and why is that? [23 words]
14. Why is trust absolutely critical to a well-functioning financial system? [18 words]
15. Mortgages, college and car loans, and the financing of appliance purchases all create what? [1 word]
16. Why do central banks automatically supply reserves when the banking system runs short of the requirement? [16 words]
17. Investment, the key determinant of demand, is extremely expensive and represents a long-term and largely irreversible commitment. On top of that, the nature of the real world is such that entrepreneurs lack the basis for making reliable forecasts of future profit. Why, then, does anyone invest at all? [5 words]
18. Why will the main part of an economic upturn not continue indefinitely? How does this create a recession (sometimes catastrophically)? [109 words]

19. How do stock prices affect firm behavior and financing beyond the initial offering? [53 words]
20. How is it that a loan shows up on both sides of a bank's balance sheet? While they clearly don't need anyone's savings to make the loan, why do they not (at least initially) even worry about having sufficient reserves to make the loan and when they do look for those reserves, where will they go first? [33 words]
21. Commercial banks and similar institutions do not realistically face what kind of constraints in lending? [2 words]
22. What is the real key to an institution's financial wealth? That number indicates what in terms of how far they are from insolvency?
23. What was Lehman Brothers net worth-to-asset ratio in 2008 and what did this indicate? How much did the market lose in about a week in 2008?
24. Why is the fact that individuals are less reluctant to commit to financial than physical investment a mixed blessing? When is the negative side particularly true and why might one particularly expect problems at the top of the business cycle? Last, what are individuals and financial institutions constantly tempted to do? [119 words]

### **EXCHANGE RATE DETERMINATION: POST KEYNESIAN**

#### *Currencies, Capital Flows, and Crises: Chapter One*

25. In the first few pages, what does Harvey appear to be arguing will be the key element of the Post Keynesian view in terms of what drives exchange rates? [37 words]
26. What three things does the Institutional influence on the book mean for foreign exchange (hint: organization, a priori assumption, and market behavior)? [120 words; three things]

#### *Lecture*

27. In the Neoclassical or Mainstream model, what maintains the equality of investment and saving and at the same time guarantees full employment? This is also called the loanable funds theory of interest. Note that this is also explained in the book on pages 5-6. [95 words plus graph]
28. In Keynes' model, what maintains the equality of investment and saving and allows for less-than-full employment equilibrium? Note that this is discussed on pages 6-7 of the book. [bunch of math plus explanation]

### **Foreign Currency Market Structure**

#### *Currencies, Capital Flows, and Crises: Chapter Three*

29. Concerning foreign currency wholesalers, what are they willing to do on a continuous basis and what does that entail? What is their goal (i.e. how do they earn a profit) and upon what does this depend? [61 words]
30. What does foreign exchange retailing involve, what does that mean, and how do they generate income? [27 words]
31. Who are those acting commercially in the foreign exchange market? [6 words]

32. Those wholesaling face a complex world. How do they make their money? What makes this not so simple? [85 words]
33. Which level of foreign currency activity essentially creates the demand for currency (while the other two accommodate)? Explain how the three roles interrelate. [26 words]

### **Expectations and Decision Making**

*Currencies, Capital Flows, and Crises: Chapter Three*

34. What can be said given that portfolio capital flows dominate the foreign exchange market (regarding expectations and outcomes)? This is not true under rational expectations because agents are assumed to be forecasting an event that is what? [19 words]
35. List and explain the five stages of decision making. Most of an agent's time would be spent in which two? [81 words]
36. List and explain the three heuristics (not the biases). [126 words without examples]
37. What are the forecast-construction biases introduced by each of the three heuristics with respect to forecasting exchange rate movements? [62 words]
38. What is true of probability judgements regarding that to which they are attached and their nature? What is true of information in this context? [48 words]
39. Agents obviously prefer to claim credit and avoid blame. How does this create an incentive to follow the crowd? [chart with a brief statement regarding which row is preferred and why]
40. List and explain Keynes' five observations regarding the workings of asset markets (uncertainty, low confidence, convention, quick results, and animal spirits). [240 words]
41. Explain how volatility is created by uncertainty, availability, representativeness, anchoring, the desire for quick results, animal spirits, and convention. [151 words]
42. Explain how bandwagons are created by availability, anchoring, representativeness, increasing confidence /forecast substantiation, and credit/blame issues. [162 words]

*Khan, Habib Hussain, et al. "Heuristics and stock buying decision: Evidence from Malaysian and Pakistani stock markets." Borsa Istanbul Review (2017).*

You can skip to the conclusion (it starts with a summary of the paper).

[http://personal.tcu.edu/jharvey/40223/Heuristics\\_and\\_Stock\\_Buying\\_Decision.pdf](http://personal.tcu.edu/jharvey/40223/Heuristics_and_Stock_Buying_Decision.pdf)

43. Why investors hold a losing stock too long? [14 words]
44. Why might an investor who is exposed to the representativeness bias be more likely to buy a wrong stock for their portfolio? [28 words]
45. The authors argue that investors tend to think that firms who advertise the most heavily are also the best. To which heuristic do they attribute this? Briefly explain what you think must be going on in such instances. [27 words]

### **Exchange Rates and Trade Imbalances**

*Currencies, Capital Flows, and Crises: Chapter Four*

46. In what way does the exchange rate play a role similar to that outlined for interest rates (from the Neoclassical perspective) in chapter one? [48 words]

*Lecture*

47. Be able to manipulate the exchange rate graph (be sure you can label the actual exchange rate, the balanced-trade exchange rate, imports, exports, capital inflows, capital outflows, the trade balance, and the capital account balance). [whatever!]

FYI, Chapter 4 in the book, “Leakages, injections, exchange rates, and trade (im)balances,” explains these graphs in detail.

\*\*\*\*\*probably to about here for exam one\*\*\*\*\*

*Harvey: The International Monetary System and Exchange Rate Determination: 1945 to the Present*

<http://personal.tcu.edu/jharvey/40223/IMSandFX1945.pdf>

48. By what have exchange rates been marked and why is this problematic (be sure to cover the consequences for the second issue completely)? [35 words]
49. The fixed-exchange rate system Bretton Woods collapsed in the early 1970s, but the spectacular growth of the capital market really began when? [4 words]
50. What did Keynes believe regarding capital flows with respect to defending parities? How long did he believe such policies should be in place? [31 words]
51. Who did Keynes think should be allowed to convert currency and what arrangement was actually adopted? [17 words]
52. How did the attempt to control capital flows by balkanizing the market backfire? [you’ll have to work on this one a bit—it’s there, but you have to draw it out; 26 words]
53. Please list the policy (2), exogenous (3), and endogenous (2) factors that have contributed to the growth of the capital market since the collapse of Bretton Woods. [34 words]

*Quinn and Harvey: Speculation and the Dollar in the 1980s*

[http://personal.tcu.edu/jharvey/40223/Spec\\_and\\_Dollar\\_1980s.pdf](http://personal.tcu.edu/jharvey/40223/Spec_and_Dollar_1980s.pdf)

54. What are institutionalist economists drawn to ask when studying economic phenomena and what do you think that must mean? [38 words]
55. What is the Neoclassical argument that justifies the operation of an unregulated asset market? [78 words]
56. What did Keynes and Veblen argue with respect to unregulated asset markets (not physical investment; note that what they have to say is slightly different)? [63 words]
57. What sort of pattern has US exchange rate policy followed since WWII (the US would go back and forth between these two states)? [9 words]
58. What did the dollar do in the early 1980s and what was the reaction of the government? Who forced a change in attitude in the mid-1980s and what did the US do thereafter? [38 words]
59. What core concepts did Neoclassical economics begin to test given the apparent irrationality of the dollar’s fluctuations in the 1980s? [5 words]

## Open Economy Z-D Diagram

*Currencies, Capital Flows, and Crises: Chapter Five*

60. Why is the D curve sloped as it is? [35 words]
61. What determines the intercept of the D curve (what it was in the *General Theory*)? [8 words]
62. The Z curve shows the revenue that firms must what? [19 words]
63. Why does the Z curve get steeper? Be sure to explain in terms of sales and the payroll as well as marginal returns. [55 words]
64. What are the conclusions drawn from the equations used to derive the BTFX curve and how do they affect the latter's slope? [73 words]
65. What must be true when BTFX is flatter? [20 words]
66. Explain how the demand for money can be broken into two distinct parts. [equation plus 55 words]
67. On the FXM curve, what forces are assumed to be driving net capital inflows (show by equation)? [equation]

*Lecture*

*The following three answers are available at:*

[http://personal.tcu.edu/jharvey/40223/ZD\\_Upward\\_Shift\\_D.pdf](http://personal.tcu.edu/jharvey/40223/ZD_Upward_Shift_D.pdf)

[http://personal.tcu.edu/jharvey/40223/ZD\\_Contractionary\\_Monetary.pdf](http://personal.tcu.edu/jharvey/40223/ZD_Contractionary_Monetary.pdf)

[http://personal.tcu.edu/jharvey/40223/ZD\\_Change\\_Expected\\_Currency.pdf](http://personal.tcu.edu/jharvey/40223/ZD_Change_Expected_Currency.pdf)

*Because of the above links I don't check these on study question lists.*

68. Show the effect of a rise in investment or a fiscal stimulus on the open economy Z-D diagram. [graph plus schematic]
69. Show the effect of a rise in interest rates on the Post Keynesian open economy Z-D diagram. [graph plus schematic]
70. Show the effect of a fall in the expected value of the dollar in the Post Keynesian open economy Z-D diagram. [graph plus schematic]

## The Mental Model

*Currencies, Capital Flows, and Crises: Chapter Five*

71. Explain the concept of medium-term expectations, including how they affect the significance of events. [97 words]
72. Why are agents not as capricious as they could be in deciding what is important in exchange rate determination and what does their worldview recognize? [49 words]
73. What are the "indicators" on the Mental Model diagram? [22 words]
74. What four Mental Model variables have historically been most important to agents (please list in order)? [6 words]

*Lecture*

75. Draw the complete Mental Model diagram as shown in the reading, but you may omit "desire to cash in FX" and "forecast confidence." [schematic]

\*\*\*\*\*probably to about here for exam two PLUS 80-85\*\*\*\*\*

## Financial Crises

### *Currencies, Capital Flows, and Crises: Chapter Five*

76. Currency-price divergence occurs when the actual exchange rate is pulled away from the level consistent with the market's mental-model forecast (i.e., away from where agents' forecasts say it should be). What is it that can pull it away and when it takes over what two factors can add fuel to the fire? With respect to how it manifests itself in a fixed exchange rate regime, what is one of the central premises and what may it cause speculators to do? [83 words]
77. In the context of currency-price divergence, what do Post Keynesian economists view as a common candidate for dramatic events that may trigger bandwagon-dominated runs?
78. Financial-returns divergence occurs when the rates of profit implied by financial asset price changes exceed those the actual asset issuers are generating. What is the implication for crises about the behavior of financial vs. real returns (with respect to what the business cycle will cause; you don't need the stuff in parentheses)? As expected physical and financial returns diverge, what may exacerbate the situation? [51 words]
79. Financial fragility results when economic agents take on debt to the point that they could quickly become insolvent given even a moderate disruption of their cash flow. Inevitably, given the precarious position in which firms, consumers, and banks have placed themselves, defaults occur. For what three reasons? [53 words]

### *Harvey: Currency Market Participants' Mental Model and the Collapse of the Dollar: 2001 to 2008*

[http://personal.tcu.edu/jharvey/40223/Collapse\\_of\\_the\\_Dollar\\_2001\\_to\\_2008.pdf](http://personal.tcu.edu/jharvey/40223/Collapse_of_the_Dollar_2001_to_2008.pdf)

80. According to Oberlechner and Hocking, about what do agents care more (actually, most, though this is not discussed in the Harvey article) in terms of the news they use in their forecasts and why is that so? [32 words]
81. According to Oberlechner and Hocking, what is the primary source of dealers information and the primary source of their primary source? What has been the consequence of that(both in terms of what financial markets may be about and how rumors are affected as they cycle through the loop) ? [57 words]
82. What were the most common explicit responses when agents were asked directly the metaphor they used to understand currency markets? What were they implicitly? How do Oberlechner and Hocking distinguish between the explicit and implicit metaphors (in terms of of what they may be indicative)? [64 words]

### *Harvey: Exchange Rate Behavior During the Great Recession*

[http://personal.tcu.edu/jharvey/40223/Exchange\\_Rate\\_Behavior\\_Great\\_Recession.pdf](http://personal.tcu.edu/jharvey/40223/Exchange_Rate_Behavior_Great_Recession.pdf)

83. According to Harvey, if trade balances drove currency prices then the dollar should have done what since early 1991? [two words]
84. What often serves as an anchor to overall movements and a major focus for the formation of medium-term expectations? [3 words]



85. What are the names of the two periods over which the dollar appreciated despite the financial crisis? [6 words]

### **Applying the Model to History**

*Currencies, Capital Flows, and Crises: Chapter Six*

see also [http://personal.tcu.edu/jharvey/40223/Six\\_Stages\\_of\\_the\\_Dollar.pdf](http://personal.tcu.edu/jharvey/40223/Six_Stages_of_the_Dollar.pdf)

and <http://personal.tcu.edu/jharvey/40223/FinancialCrisesSummary.pdf>

*I don't bother to check these study questions since the answer is available at the above link.*

86. During Bretton Woods Collapse and Adjustment (1970-79), what happened to the dollar (rise or fall)? What were the major factors responsible for this movement both on the mental model schematic and the open economy Z-D diagram (go as far to the left as possible when appropriate)? How did the U.S. trade balance change? Note that there will be 4 mental model factors and 2 Z-D shifts (note that the bandwagon and medium-term exchange rate bias count in this total). You need not mention “ignored” variables (though they are very interesting!). [79 words]
87. During Dollar Run Up (1980-February 1985), what happened to the dollar (rise or fall)? What were the major factors responsible for this movement both on the mental model schematic and the open economy Z-D diagram (go as far to the left as possible when appropriate)? How did the U.S. trade balance change? Note that there will be 5 mental model factors and 2 Z-D shifts (note that the bandwagon and medium-term exchange rate bias count in this total). You need not mention “ignored” variables (though they are very interesting!). [100 words]
88. During Dollar Reversal (March 1985-April 1995), what happened to the dollar (rise or fall)? What were the major factors responsible for this movement both on the mental model schematic and the open economy Z-D diagram (go as far to the left as possible when appropriate)? How did the U.S. trade balance change? Note that there will be 5 mental model factors and 2 Z-D shifts (note that the bandwagon and medium-term exchange rate bias count in this total). You need not mention “ignored” variables (though they are very interesting!). [75 words]
89. During the Last Days of the Mark (1995-1998), what happened to the dollar (rise or fall)? What were the major factors responsible for this movement both on the mental model schematic and the open economy Z-D diagram (go as far to the left as possible when appropriate—can't quite do it on one, but you'll see)? How did the U.S. trade balance change? Note that there will be 3 mental model factors and 3 Z-D shifts (note that the bandwagon and medium-term exchange rate bias count in this total). You need not mention “ignored” variables (though they are very interesting!). [51 words]
90. During the Euro Decline (1999-2001), what happened to the dollar (rise or fall)? What were the major factors responsible for this movement both on the mental model schematic and the open economy Z-D diagram (go as far to the left as possible when appropriate)? How did the U.S. trade balance change? Note that there will be 4 mental model factors and 2 Z-D shifts (note that the bandwagon and medium-term exchange rate bias count in this total). You need not mention “ignored” variables (though they are very interesting!). [59 words]

91. During the Euro Recovery (2001-2007 or 8), what happened to the dollar (rise or fall)? What were the major factors responsible for this movement both on the mental model schematic and the open economy Z-D diagram (go as far to the left as possible when appropriate)? How did the U.S. trade balance change? Note that there will be 4 mental model factors and 3 Z-D shifts (note that the bandwagon and medium-term exchange rate bias count in this total). You need not mention “ignored” variables (though they are very interesting!). [62 words]
92. Give the following for the Mexican Financial Crisis: Boom Trigger, Bust Trigger, Tension Points (including Currency Price Divergence, Financial Returns, and Financial Fragility), and Consequences. FYI, there will be two items under Financial Returns, three under Currency Price Divergence, two under Financial Fragility, and three under Consequences.
93. Give the following for the Asian Financial Crisis: Boom Trigger, Bust Trigger, Tension Points (including Currency Price Divergence, Financial Returns, and Financial Fragility), and Consequences. FYI, there will be three items under Financial Returns, three under Currency Price Divergence, two under Financial Fragility, and three under Consequences.

*Harvey: Five Reasons Why The Greeks Were Right*

<http://www.forbes.com/sites/johntharvey/2015/07/07/five-reasons-greeks-were-right/>

93. List but do not explain the five reasons Harvey says the Greeks were right to reject the bailout proposal. [59 words]
94. With respect to Harvey’s point that the Greek crisis is a function of how the Eurozone is organized, list but do not explain the three interrelated factors. What self-destructive trend do they create (just show the schematic)? [41 words]
95. Harvey says that, ironically, austerity is a “solution” given how the euro zone is set up. How does he say would it tend to reduce their debt? Why is that bad in terms of bias it creates and what does Europe truly need? [92 words]

## **Policy**

*Currencies, Capital Flows, and Crises: Chapter Seven*

96. In general, what is it that Post Keynesians want (and what is also desirable)? [14 words]
97. How does the international monetary system as designed frustrate the Post Keynesian goals for the economy (five items, list only)? [ words]
98. Briefly explain what it means to say that currency prices are mis-determined because they are driven by short-term time horizons instead of long. [173 words; this will take some hard work!]
99. Briefly explain what means to say that currency price volatility reduces the expectation of profit from investment and, therefore, the level of aggregate demand. [34 words]
100. Briefly explain what it means to say that currency price mis-determination and volatility reduce the level of world trade. [33 words]
101. Briefly explain what it means to say that currency markets contribute to developing countries’ woes. [44 words]

102. Where does the core of any successful international monetary reform lie? [2 words]
103. What are the central features of a Chilean-style policy and how did it properly discriminate between types of capital flows? [53 words]