

EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT
THIRD YEAR FIRST SEMESTER EXAMINATION IN BACHELOR OF COMMERCE -2017/18
SPECIALIZATION IN BUSINESS ECONOMICS (July 2019)
ECN 3043 International Trade and Finance

Time: 03 Hours

Answer all Questions

1. Consider a trade agreement between U.S.A and Mexico with a simple two good case, brooms and microchips. Each country has 10 workers who can produce either microchips or brooms.

A worker in U.S.A can produce 9 microchips a day or 1 broom a day. A worker in Mexico can produce 1 microchip or 9 brooms a day. This can be summarizing in the following table:

	Output per Worker	
	USA	Mexico
Microchips	9	1
Brooms	1	9

- i. Draw the Production Possibilities Frontier (PPF) of microchips and brooms for U.S and Mexico (04 Marks)
- ii. Explain how trade can benefit both the U.S and Mexico. Which country will import brooms and which country microchips? (04 Marks)
- iii. Suppose the terms of trade (i.e., prices) are such that one microchip is traded for one broom. Furthermore, suppose each country wants to consume the same amount of brooms and microchips. Find
 - a. how many microchips and brooms are produced in each country,
 - b. the consumption of brooms and microchips in each country, and
 - c. the trade between U.S and Mexico. (06 Marks)
- iv. If the profits of the brooms and microchips producers are higher the more they produce, who will oppose and who will support the agreement in the U.S? (06 Marks)

(Total 20 Marks)

2. i. Distinguish between factor Intensity and factor endowment with example (04 Marks)

ii. Assume that Sri Lanka produces Computer (C) and Food (F) using Capital (K) and Labour (L). Unit factor requirements are fixed and given by
 $a_{KC} = 3$, $a_{KF} = 1$, $a_{LC} = 2$, $a_{LF} = 4$
 a_{ij} is the number of unit of factor i required to produce a unit of good j

Which industry is capital intensive? Why? (04 Marks)

iii. The Heckscher-Ohlin Model suggests that the basis of comparative advantage lies primarily in a difference in factor endowments between countries, and that if countries enter into international trade based on that comparative advantage, they will be better off in real terms." Discuss this statement with a diagram. (08 Marks)

iv. What is meant by "Leontief Paradox" (04 Marks)

(Total 20 Marks)

3. i. Distinguish between **Inter Industry Trade** and **intra Industry Trade** with examples. (04 Marks)

ii. What factors determine the intra Industry trade in goods? Explain (05 Marks)

iii. "With increasing returns to scale, mutually beneficial trade can occur even if nations are identical in every way" explain with a diagram (05 Marks)

iv. Distinguish between **Resource oriented industry**, **Market oriented industry** and **Footloose industry**. (06 Marks)

(Total 20 Marks)

4. i. Explain the various types of economic integrations. (5 Marks)
- ii. What is meant by the terms "trade creation and trade diversion"? (4 Marks)
- iii. Demonstrate the net welfare effect of a Custom Union by using graphical methods (7 Marks)
- iv. What is the other dynamic and static effect of the Custom Union? (4 Marks)
- (Total 20 Marks)**

5. i. What are the non-tariff trade policy instruments that are practiced by different countries? (4 Marks)
- ii. Define import demand curve and export supply curve of a country (4 Marks)

- iii. Suppose that Home country has
- | | |
|--------|--------------|
| demand | $P = 38 - Q$ |
| supply | $P = 26 + Q$ |

- Foreign country has
- | | |
|--------|------------------|
| demand | $P^* = 34 - Q^*$ |
| supply | $P^* = 22 - Q^*$ |

- a. Find the Home and foreign countries pre trade equilibrium price?
- b. Derive the Home country's **import demand curve** and Foreign country's **export supply curve**.
- c. What is the world price under free trade?
- d. Find the quantity of export and import.
- e. Suppose that Home country places a tariff of $t = 2$ \$ on each unit import from foreign country what is the new demand of home country?
- f. What is the new price for home and foreign countries after the tariff? (12 Marks)

(Total 20 Marks)