EASTERN UNIVERSITY, SRI LANKA.
FACULTY OF COMMERCE AND MANAGEMENT
FINAL YEAR FIRST SEMESTER EXAMINATION IN COMMERCE 2003/04
(November/ December-2004)

ECN 4024 - INTERNATIONAL TRADE AND FINANCE

Answer all questions. Time: 3 hours

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1. Explain the followings

    i. Comparative advantage and absolute advantage
    ii. Factor endowment and factor intensity.
    iii. Terms of trade and offer curves
    iv. Nominal tariff and effective tariff.
    v. Custom union and Economic union.
    vi. Spot exchange rate and forward exchange rate.
    vii. Arbitrage and speculation.
    viii. SAFTA and NAFTA.
    ix. Trade and product differentiation
    x. Gains from trade and gains from speculation

(4x10 Marks)

2. Suppose that USA and France are producing two different goods Cheese and Wine. The unit labour requirement for the production of two goods are indicated in the following table

Country	Cheese	Wine
USA	1	2
France	6	3

Both countries have 24 units labour available for the production of two goods.

a. What are the relative price of two goods in both countries
b. Which country has comparative advantage in cheese and wine?
c. Show how specialisation and trade between the two countries can be mutually beneficial by choosing plausible terms of trade.

(15 Marks)

3. i. Effective tariff rate is heavily depending on domestic value added of commodity. Explain.

(5 Marks)

ii. The nation A is small unable to affect world price. It import peanuts at the price of 10/= per kg.

The demand curve is

$$D = 400 - 10\,p$$

The supply curve is

$$S = 50 + 5\,p$$

Determine the free trade equilibrium. If an import tariff of 50% and import quota that limits the imports to 50kg is imposed calculate and graph the following effects.

a. domestic price
b. domestic production
c. domestic consumption
d. Deadweight loss.
e. Consumer , producer surpluses

(10 Marks)

4. i. Trade creating custom union benefits the member countries than trade diverting custom union. Do you agree? Explain your answer with partial equilibrium analysis.

(15 Marks)

5. i. What are the main functions of foreign exchange market?

(3 Marks)

ii. What are the main determinants of exchange rate of a country.

(4 Marks)

iii. What is meant by forward discount and forward premium in foreign exchange transactions?
Assume that the spot rate is 1£ = 1.50 US$. a foreign currency dealer wish to sell one million US dollars against sterling pounds. He has to receive six month forward exchange rate for this transaction. 15% and 10% are the one year interest rates in USA and UK respectively.

a. What is the six month forward rate
b. What is the forward discount or forward premium

(8 Marks)