

UNIVERSITY OF RUHUNA

2016/2017 Academic Year B. A. (Special) Degree - 3000 Level

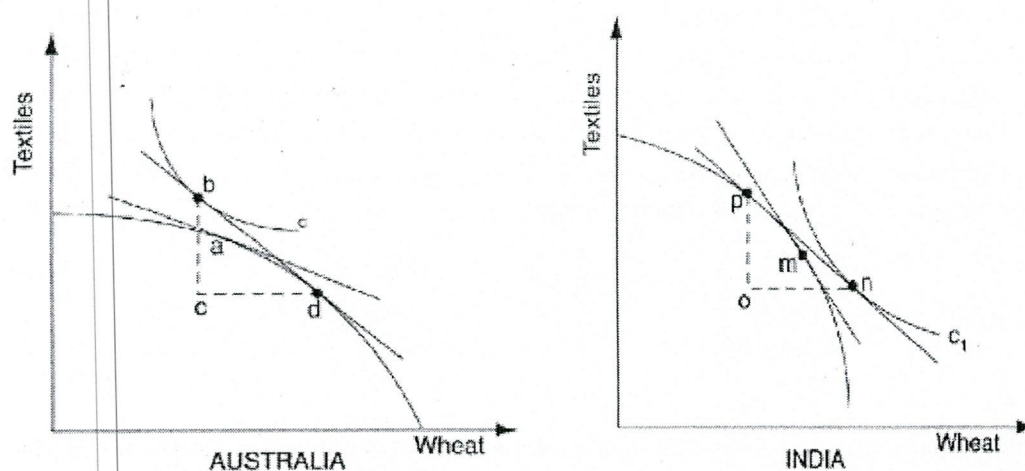
1<sup>st</sup> Semester Examination – Oct./Nov. 2017

ECN 31633 - International Trade and Finance

Answer Four (04) questions only.

Time: 03 Hours

(1)



Identify the underlining trade theory shown in the above diagram and explain how trade occurs between Australia and India. Your answer should contain the trade theory, the concept of relative price, international exchange rate, trade triangle, and the gains from specialization and trade.

(15 Marks)

(2) Using the modified Ricardian model with relevant graphical illustrations, derive the following conclusions related to factor movements between two countries.

- (i) Transfer of capital completely eliminates the difference between Marginal Product of capital in the two countries.
- (ii) Factor movements increase the global production.
- (iii) Transfer of capital causes redistribution of income from capital owners to workers in one country, and workers to capital owners in the other country.

(5x3=15 Marks)

(3) (i) "Government intervention to free trade through both tariffs and subsidies results welfare losses. Therefore, free trade is the optimum policy for a small country". Do you agree with this statement? Explain your answer.

(8 Marks)

(ii) Contrast and compare the welfare effects of Tariffs Vs. Quotas for a small country.

(7 Marks)

(4) Suppose you have been newly appointed as the Governor of the Central Bank of Spiderland. Spiderland is a country maintaining a floating exchange rate. The economy is described by normal IS-LM curves, however, no study has been so far done on its external capital movements of this economy and therefore, the degree of capital mobility is not known. The secretary to the treasury strongly believes that the fiscal policy is the most appropriate instrument to accelerate economic growth of this country. Construct an argument based on Mundell-Fleming model to show that the secretary to the treasury is wrong and the monetary policy is the most appropriate.

(15 Marks)

(5) It is usually recommended that exchange rate management policy for achieving external balance and fiscal policy for achieving internal balance of a country.

(i) What do you mean by external and internal balance? Graphically show the external and internal balance in Salter-Swan diagram.

(ii) Show that two countries facing similar problems such as Trade deficit and Unemployment simultaneously, will need different policy assignments to reach equilibrium.

(iii) Show that some countries never reach equilibrium when they stick to the notion that the exchange rate management policy is for external balance and fiscal policy is for internal balance

(5x3=15 Marks)

(6) What is the difference between currency depreciation and devaluation? Discuss the concussions given by Marshall-Lerner condition, J curve analysis and Absorption approach in relation to currency devaluation.

(15 Marks)

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