

THE OPEN UNIVERSITY OF SRI LANKA
DEPARTMENT OF SOCIAL STUDIES
BA DEGREE PROGRAMME IN SOCIAL SCIENCES – LEVEL 5
FINAL EXAMINATION – 2008/2009
SSU 3204 – INTERNATIONAL TRADE & FINANCIAL RELATIONS



DURATION – THREE (03) HOURS

Date: 13th June 2009

Time: 9.30 a.m. – 12.30 p.m.

Answer five (05) questions only. Each question carries 20 marks.

1. (i) Explain why countries engage in international trade. (06 marks)
- (ii) The mercantilists argued that the aim of a nation should be to increase its wealth through acquisition of precious metals. What was the role of the government in achieving the above objective?
Explain whether the governments of present day could play the same role in order to maintain favorable balance of trade. (14 marks)
2. (i) What is Labour Theory of Value? (03 marks)
- (ii) According to Adam Smith, what is the basis for trade between two countries? (03 marks)
- (iii) Answer the following questions using the given table.

Country	Labour cost of production (Labor hours per unit of output)	
	Food	Clothes
Sri Lanka	4	2
India	5	10

Suppose each country has 160 hours of labour to produce each of the commodities.

- (a) If trade is to take place on the basis of absolute advantage, how will trade take place between two countries? (04 marks)
- (b) Explain how the two countries can gain if trade takes place on the basis of comparative advantage. (10 marks)
3. (i) What is the main difference between David Ricardo's trade theory and Heckscher-Ohlin Theory? (05 marks)
- (ii) According to Heckscher-Ohlin Theory, what is meant by factor price equalization? Explain with an example. (08 marks)
- (iii) "The production possibility curves of two countries can differ as a result of different factor endowments in the two countries". Do you agree? Explain with illustrations. Consider the two factors as capital and labour. (07 marks)

4. (i) "Although free trade is beneficial, countries impose various types of restriction on free trade".
 (a) Identify the measures that can be imposed to prevent free trade. (04 marks)
 (b) Explain the reasons why a country may restrict free trade. (06 marks)
- (ii) Using illustrations explain the effects of import tariff on producers and consumers. Comment on the consumer and producer surplus. (10 marks)
5. (i) What is the difference between flexible and fixed exchange rate regimes? (04 marks)
- (ii) Explain using illustrations, what happens to the value of Sri Lankan Rupee as against US Dollar in following situations, under floating exchange rate system.
 (a) More and more Sri Lankans travel abroad.
 (b) Increase in demand for goods made in Sri Lanka by foreigners.
 (c) More foreign investments come into Sri Lanka.
 (d) Increase in demand for foreign made automobiles by Sri Lankans. (08 marks)
- (iii) (a) Briefly explain the main components of Balance of Payments account? (03 marks)
 (b) Explain why a country should maintain a Balance of Payments account? (05 marks)
6. "Although countries, especially the developed countries encourage Free Trade, under present recessionary conditions, most developed countries seem to have adopted protectionist measures". Do you agree? Critically analyse. (20 marks)
7. Present recessionary conditions, especially in the leading trading partners of Sri Lanka, has had a negative impact on the Sri Lankan exports. Some economists were of the view that the Sri Lankan rupee should be allowed to depreciate in order to make the domestic exports more competitive.
 How valid is this argument? Critically analyse the impact of depreciation on the Sri Lankan economy. (20 marks)
8. (i) What are the benefits of regional trade arrangements? (07 marks)
 (ii) Explain the difference between Custom Union and Free Trade Area. (04 marks)
 (iii) What are the factors that affect the intra-regional trade between SAARC countries? Explain with examples. (09 marks)
9. Write brief notes on the following:
 (i) Terms of trade
 (ii) Price-specie flow mechanism
 (iii) Product Life Cycle approach
 (iv) Economic union (05 marks for each)

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