THE OPEN UNIVERSITY OF SRI LANKA
BA DEGREE PROGRAMME IN SOCIAL SCIENCES – LEVELS V
FINAL EXAMINATION – 2006 (1ST SEMESTER)
INTERNATIONAL TRADE & FINANCIAL RELATIONS - SSU 3204

DURATION: TWO (03) HOURS

Date: 25th November 2006 **Time: 9.00a.m. – 12.00 noon**

Answer five questions only. Each question carries 20 marks.

1. (a) Explain why the nations engage in trade?
   (b) What were the policies emphasised by Mercantilists, in order to maintain surplus in trade? Do you think that these policies are still relevant?

2. (a) What is Price-Specie-flow mechanism?
   (b) Answer the following questions using the given table.

Country	Labour cost of production (labour hours per unit of output)	
	Cloth	Meat
Sri Lanka	2	6
Australia	8	2

   (i) Suppose under 'autarky' each country has 120 hours of labour to produce each of the given commodities.
   (ii) Explain how the two countries benefit if trade takes place on the basis of absolute advantage.
   (c) What is the main weakness in absolute advantage theory?

3. (a) What arguments can you forward against free trade?
   (b) Explain the impact of import tariff on consumers and domestic produces with illustrations.

4. (a) What is the main difference between Ricardo's and Hecksher Ohilin Theories?
   (b) What are the long run dynamic gains from trade?
   (c) Suppose the workers of country A and B have the following production capacities per year.

Country	Goods	
	X	Y
A	80	40
B	40	80

Assume two countries are characterized by constant opportunity cost and the trade ratio is 1:1.

Explain how the two countries can gain from specialization, with the help of production possibility curves.

5. Write brief notes on the following:
   (i) Dumping
   (ii) Terms of trade
   (iii) Economic union
   (iv) Product life cycle approach

6. (a) Explain how the exchange rate is determined under fixed and floating exchange systems?
   (b) What are the advantages and disadvantages of flexible exchange rate?
   (c) If exchange rate is floating, comment on the value of Sri Lankan rupee, under following given conditions, using illustrations.
      (i) Domestic income increases
      (ii) High inflation in USA relative to Sri Lanka
      (iii) High domestic interest rate relative to USA.

7. (a) Briefly explain the objectives of SAPTA.
   (b) Discuss about the constraints that are faced by SAARC member countries in promoting intra-regional trade.

8. (a) What were the important changes introduced by WTO, compared to GATT?
   (b) "Even though the membership of WTO limits a country's freedom on trade related matters, the advantages of membership exceeds such disadvantage". Do you agree? Explain taking Sri Lanka as an example.

9. (a) What are the benefits of regional trade arrangements?
   (b) Use the partial equilibrium analysis to answer the following question.
   Production cost of good X in home country (H), countries P and W are given below

	Country		
	H	**P**	**W**
Unit production cost in $	40	30	22

   (i) Suppose home country imposes a tariff of 50% on both countries (P & W), how should the profitable trade take place?
   (ii) Suppose home country forms a custom union with county P, while retaining tariff of 50% against others.

   Explain the trade creation and diversion effects of the above.

*****Copyrights reserved*****