MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

BACHELOR OF ARTS

EAE 307: INTERNATIONAL ECONOMICS I

DATE: 20/8/2021 **TIME: 11.00-1.00 PM**

INSTRUCTIONS:

- **(i) Answer question one (Compulsory) and any other two questions**
- **(ii) Do not write on the question paper**
- **(iii) Show your working clearly**

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Clearly distinguish between International Trade and International Finance (4 marks)

b) Based on Absolute Advantage Theory, demonstrate the gain when countries trade between each other (6 marks)

c) Using well labeled diagrams for country A and country B, explain how specialization and trade along lines of comparative advantage can increase the total world output of the two goods (X, Y) available for consumption. Country A has comparative advantage in production of good X and country B has comparative advantage in production of good Y. (8 marks)

d) Briefly discuss the impact of Mercantilist beliefs (6 marks)

e) Using a well labeled diagram explain production and consumption gains from trade (6 marks)

QUESTION TWO (20 MARKS)

a) Kenya specializes in the production of Maize and Uganda specializes in the production of Bananas. The two countries use labor as the only factor of production. Using well labeled diagrams, demonstrate the free trade equilibrium for Kenya and Uganda. (Assume fixed costs) (8 marks)

b) Give four reasons why factor prices between trading countries are not equalized in the real world though equalized in countries with same level of development (4 marks)

c) Explain how H-O model has been modified to explain patterns of trade (8 marks)

QUESTION THREE (20 MARKS)

a) Tanzania specializes in the production of Avocados and Ethiopia specializes in the production of Oranges. The two countries use labor as the only factor of production. Using well labeled diagrams, demonstrate the international free trade equilibrium for Tanzania and Ethiopia. (Assume increasing costs) (8 marks)

b) Explain two advantages and two disadvantages of specific tariff (4 marks)

c) A country's terms of trade and imports is as shown in the table below:

Terms of Trade	Demand for Imports	Supply of Exports
1X: 1Y or $P_X/P_Y = 1$	10 Units	-
1X: 2Y or $P_X/P_Y = 2$	44 Units	-
1X: 3Y or $P_X/P_Y = 3$	81 Units	-
1X: 4Y or $P_X/P_Y = 4$	120 Units	-

i. Calculate the country's respective exports (2 marks)

ii. Show the country's Offer Curve in a well labeled diagram (6 marks)

QUESTION FOUR (20 MARKS)

a) Assuming that there are two countries A and B. A is the relatively capital-abundant and B is labor abundant. Using a well labeled demonstrate the Heckscher-Ohlin Theory (8 marks)

b) What is the Leontief-Paradox? Explain your answer in detail (4 marks)

c) Graphically show the welfare effects of imposing a tariff by a small country (8 marks)

QUESTION FIVE (20 MARKS)

a) Based on Stolper–Samuelson Theory, explain using well labeled diagrams the relationship between output prices and factor prices for a labor abundant country and capital abundant country (8 marks)

b) Give four main reasons for imposing a tariff by a small country (4 marks)

c) Use graphs to explain the role of taste in determining comparative advantage (8 marks)