**KA6a INTERNATIONAL ECONOMICS**

Fidelis Landy

**Answer Four (4) questions out of the Five (5) questions in English.**
**Each question carries equal weight.**
**Return the paper with your answer.**
**Good Luck**

**1. The Krugman Model**

**a.** Explain briefly the basic assumptions of the Krugman model of international trade
**b.** Present graphically the Krugman model of trade between two identical countries.
**c.** What are the gains of trade in the Krugman model

**2. Free Trade, the Price Levels and the Exchange rate**

**a.** Provide arguments for free trade
**b.** What are the shortcomings of the Purchasing Power Parity (PPP) concept?

**3. Resource constraint in the Ricardian Model**

Consider the following table

| | Cloth | wine |
|---|---|---|
| England | 1 hr. / yard (yd). | 3hrs. /barrel (bbl). |
| Portugal | 2hrs. / yard (yd). | 4hrs. /barrel (bbl). |

**a.** What is the **autarky** (no trade) price of wine in terms of cloth in England and Portugal? Also what is the **autarky** (no trade) price of cloth in terms of wine in England and Portugal?

**b.** Now suppose that England has 9,000 hours of labour available in the country and Portugal has 16,000 hours of labour. Using the Production Possibility Frontier (PPF) graph show the consumption pattern in England and Portugal if both countries devote all their resources in the production of each commodity.

**c.** Assume in free trade the international price is 2.5 yards per barrel of wine (1bbl : 2.5yards ) using the same graph as in (b) show the change in consumption under free trade for both England and Portugal

**d.** Further, assume that the international price is now 2.25 yards to a barrel of wine (1bbl : 2.25 yards). Using the same graph as in (b) and (c), show the new consumption equilibrium in England and Portugal. Which country benefits from this new international price?

**e.** In light of the Ricardian model, how might you evaluate the claim by developing countries that they are at a disadvantage in trade with powerful industrialized countries?

**Please Turn Over More Questions at the Back of Paper**

**4. Heckscher-Ohlin Theory**

**a.** It was emphasised in class that, under the Heckscher-Ohlin theory of trade owners of the relatively abundant resource would advocate for free trade whiles owners of the relatively scarce resource tend to favour trade restrictions. Explain this reasoning in light of what happens to the nominal wages and capital returns in Bangladesh (a labour abundant country) as it engages in trade with the rest of the world (Hint: Factor price equalization theory)

**b.** What happens to the distribution of real income (Hint: The Stolper-Samuelson theorem)

**c.** Explain briefly why answering the question "Is trade beneficial in the Heckscher-Ohlin model" a bit difficult?

**5. Exchange Rate Mechanisms and Trade Concepts**

**a.** Provide arguments for Flexible Exchange Rates

**b.** Briefly define the following concepts

i. Mercantilism
ii. Immiserizing growth
iii. Rybczynski theorem
iv. Offer curve